FINANCIAL SECTION

STATE OF NORTH CAROLINA

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Independent Auditor's Report

The Honorable James B. Hunt, Jr., Governor
The General Assembly of North Carolina

We have audited the accompanying general purpose financial statements of the State of North Carolina as of and for the year ended June 30, 1999. These general purpose financial statements are the responsibility of the State's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit. We did not audit the financial statements of the 401-K Supplemental Retirement Income Plan, which represent 3 percent and 6 percent, respectively, of the assets and revenues of the pension trust funds; the financial statements of the North Carolina Housing Finance Agency, which represent 45 percent and 35 percent, respectively, of the assets and revenues of the proprietary component units; nor the financial statements of the State Education Assistance Authority, which represent 42 percent and 28 percent, respectively, of the assets and revenues of the proprietary component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the 401-K Supplemental Retirement Income Plan were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the State of North Carolina as of June 30, 1999, and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 15 to the financial statements, the State of North Carolina changed its method of reserving fund balance during the year ended June 30, 1999.

In accordance with *Government Auditing Standards*, we will also issue our report dated December 3, 1999 on our consideration of the State of North Carolina's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. This report will be published at a later date in the State of North Carolina's *Single Audit Report*.

The required supplementary information on year 2000 issues listed in the table of contents is not a required part of the general purpose financial statements but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because we could not evaluate the information using the criteria in Governmental Accounting Standards Board Technical Bulletin 98-1, *Disclosures About Year 2000 Issues*, as amended. In addition, we do not provide assurance that the State is or will become year 2000 compliant, that the State's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the State does business are or will become year 2000 compliant.

The combining and individual fund and account group financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, based on our audit and the reports of other auditors, is fairly presented in all material respects in relation to the general purpose financial statements taken as a whole.

The introductory and statistical sections, identified in the table of contents, were not audited by us, and accordingly, we express no opinion thereon.

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

December 3, 1999

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General Purpose Financial Statements

ALL FUND TYPES, ACCOUNT GROUPS, AND DISCRETELY PRESENTED COMPONENT UNITS COMBINED BALANCE SHEET

June 30, 1999

(Dollars in Thousands)

	Governmental Fund Types			Proprietary Fund Types	
	General	**Special Revenue**	**Capital Projects**	**Enterprise**	**Internal Service**
ASSETS AND OTHER DEBITS					
Cash and cash equivalents (Note 4)	$ 2,279,060	$ 2,459,024	$ 294,856	$ 40,152	$ 326,435
Investments (Note 4)	2,547,522	900,550	—	43,475	573,580
Deposit with Federal government (Note 4)	—	—	—	—	—
Receivables, net:					
Taxes receivable	594,212	103,499	—	—	—
Accounts receivable	95,228	24,900	15	1,254	25,505
Intergovernmental receivables	517,803	77,601	1,509	—	651
Interest receivable	20,856	10,122	—	151	1,452
Premiums receivable	—	—	—	803	139
Contributions receivable	14,413	—	—	—	5,145
Other receivables	—	8,092	—	—	—
Due from other funds (Note 8)	16,931	90,302	2,400	—	26,946
Due from component units (Note 8)	6,780	—	—	—	1,438
Due from primary government (Note 8)	—	—	—	—	—
Advances to component units (Note 8)	61,000	—	—	—	—
Notes receivable	497	111,095	—	—	—
Inventories	48,105	89,274	—	358	12,631
Food stamps	13,647	—	—	—	—
Prepaid items	—	386	—	1,290	882
Fixed assets (Note 5)	—	—	—	22,063	181,509
Goodwill	—	—	—	—	—
Sureties	—	49,618	—	—	—
Amount available in other funds	—	—	—	—	—
Amount to be provided for retirement of general long-term obligations	—	—	—	—	—
Total Assets and Other Debits	$ 6,216,054	$ 3,924,463	$ 298,780	$ 109,546	$1,156,313
LIABILITIES, FUND EQUITY AND OTHER CREDITS					
Liabilities:					
Accounts payable and accrued liabilities	$ 438,480	$ 306,626	$ 15,078	$ 777	$ 15,354
Tax refunds payable	802,768	—	—	—	—
Obligations under securities lending	2,485,454	876,961	—	19,919	197,313
Refunds and other payables	—	—	—	—	—
Tax judgements payable (Note 7)	399,000	—	—	—	—
Due to other funds (Note 8)	35,132	88,364	77	9	6,627
Due to component units (Note 8)	12,391	30,142	—	—	184
Due to primary government (Note 8)	—	—	—	—	—
Advance from primary government (Note 8)	—	—	—	—	—
Obligations under reverse repurchase agreements	—	—	—	—	—
Contracts payable	—	—	—	—	—
Notes payable (Note 7)	—	—	—	—	—
Claims and benefits payable	506,458	48	—	13,927	355,164
Capital leases payable (Note 6)	—	—	—	—	—
Bonds payable (Note 7)	—	—	—	—	—
Interest payable	287	—	—	—	—
Deposits payable	9	117,449	6,198	—	70
Distributions payable	—	—	—	—	—
Accrued vacation leave	—	—	—	278	2,870
Deferred revenue	391,945	22,714	—	3,267	3,355
Total Liabilities	5,071,924	1,442,304	21,353	38,177	580,937
Fund Equity and Other Credits:					
Contributed capital	—	—	—	41,144	59,754
Retained earnings	—	—	—	30,225	515,622
Investment in fixed assets	—	—	—	—	—
Fund balances:					
Reserved/restricted (Note 15)	1,084,077	893,364	82,076	—	—
Unreserved/unrestricted (Note 15)	60,053	1,588,795	195,351	—	—
Total Fund Equity and Other Credits	1,144,130	2,482,159	277,427	71,369	575,376
Total Liabilities, Fund Equity and Other Credits	$ 6,216,054	$ 3,924,463	$ 298,780	$ 109,546	$1,156,313

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit A-1

Fiduciary Fund Types	*Account Groups*		*TOTAL PRIMARY GOVERNMENT (Memorandum only)*	*Component Units*		*TOTAL REPORTING ENTITY (Memorandum only)*
Trust and Agency	**General Fixed Assets**	**General Long-Term Obligations**		**Proprietary**	**College and University**	
$ 1,367,677	$ —	$ —	$ 6,767,204	$ 236,201	$ 1,544,845	$ 8,548,250
60,920,382	—	—	64,985,509	655,899	2,616,392	68,257,800
1,283,540	—	—	1,283,540	—	—	1,283,540
229,250	—	—	926,961	—	—	926,961
17,924	—	—	164,826	26,976	232,002	423,804
1,562	—	—	599,126	11,199	105,398	715,723
14,877	—	—	47,458	22,491	10,048	79,997
—	—	—	942	—	—	942
129,810	—	—	149,368	—	—	149,368
—	—	—	8,092	—	—	8,092
7,515	—	—	144,094	—	61,429	205,523
710	—	—	8,928	—	1,022	9,950
—	—	—	—	14,531	42,717	57,248
25,000	—	—	86,000	—	—	86,000
351,624	—	—	463,216	1,488,015	96,077	2,047,308
1,546	—	—	151,914	751	54,534	207,199
—	—	—	13,647	—	—	13,647
—	—	—	2,558	6,582	9,037	18,177
—	3,383,063	—	3,586,635	176,728	6,247,686	10,011,049
—	—	—	—	460	—	460
499,813	—	—	549,431	—	—	549,431
—	—	145	145	—	—	145
—	—	3,095,912	3,095,912	—	—	3,095,912
$ 64,851,230	$ 3,383,063	$ 3,096,057	$ 83,035,506	$ 2,639,833	$ 11,021,187	$ 96,696,526
$ 595,331	$ —	$ —	$ 1,371,646	$ 25,231	$ 194,944	$ 1,591,821
—	—	—	802,768	—	—	802,768
3,459,281	—	—	7,038,928	123,605	587,611	7,750,144
2,021	—	—	2,021	—	—	2,021
—	—	440,000	839,000	—	—	839,000
13,885	—	—	144,094	—	61,429	205,523
14,531	—	—	57,248	—	1,022	58,270
—	—	—	—	8,886	4,547	13,433
—	—	—	—	86,000	—	86,000
—	—	—	—	—	86,891	86,891
—	—	—	—	7,010	—	7,010
—	—	3,270	3,270	28,314	20,163	51,747
87,510	—	6,932	970,039	10,938	37,426	1,018,403
—	—	904	904	2,224	997	4,125
—	—	2,451,973	2,451,973	1,535,484	897,654	4,885,111
—	—	—	287	18,035	11,882	30,204
740,766	—	—	864,492	—	388,454	1,252,946
3,550	—	—	3,550	—	—	3,550
—	—	192,978	196,126	1,579	136,580	334,285
9,748	—	—	431,029	10,929	32,526	474,484
4,926,623	—	3,096,057	15,177,375	1,858,235	2,462,126	19,497,736
—	—	—	100,898	168,642	—	269,540
—	—	—	545,847	612,956	—	1,158,803
—	3,383,063	—	3,383,063	—	5,345,426	8,728,489
58,244,647	—	—	60,304,164	—	1,777,774	62,081,938
1,679,960	—	—	3,524,159	—	1,435,861	4,960,020
59,924,607	3,383,063	—	67,858,131	781,598	8,559,061	77,198,790
$ 64,851,230	$ 3,383,063	$ 3,096,057	$ 83,035,506	$ 2,639,833	$ 11,021,187	$ 96,696,526

ALL GOVERNMENTAL FUND TYPES AND EXPENDABLE TRUST FUNDS COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

For the Fiscal Year Ended June 30, 1999 *Exhibit A-2*

(Dollars in Thousands)

	Governmental Fund Types			*Fiduciary Fund Type*	*TOTALS*
	General	**Special Revenue**	**Capital Projects**	**Expendable Trust**	***(Memorandum only)***
Revenues:					
Taxes	$ 12,168,991	$ 1,648,586	$ —	$ 397,094	$ 14,214,671
Federal funds	5,361,839	929,097	6,260	9,978	6,307,174
Local funds	436,609	31,930	1,000	99	469,638
Investment earnings	365,685	162,957	386	187,830	716,858
Interest earnings on loans	—	6,665	—	—	6,665
Sales and services	70,386	21,531	320	32,400	124,637
Sale, rental, and lease of property	6,559	20,283	71	529	27,442
Fees, licenses, and fines	277,168	618,717	7	6,856	902,748
Contributions, gifts, and grants	17,612	29,956	24,219	29,620	101,407
Funds escheated	—	—	—	20,061	20,061
Miscellaneous	152,061	16,208	3,834	499	172,602
Total revenues	18,856,910	3,485,930	36,097	684,966	23,063,903
Expenditures:					
Current:					
General government	971,304	68,551	—	6,966	1,046,821
Education	5,492,045	761,793	—	17,900	6,271,738
Health and human services	7,614,923	50,538	—	2,436	7,667,897
Economic development	133,518	236,606	—	—	370,124
Environment and natural resources	201,194	152,831	—	10,686	364,711
Public safety, corrections, and regulation	1,488,715	181,988	—	29,922	1,700,625
Transportation	—	2,508,886	—	—	2,508,886
Agriculture	72,353	209	—	4,903	77,465
Claims and benefits	—	—	—	449,303	449,303
Tax judgements	399,000	—	—	—	399,000
Capital outlay	—	—	182,793	—	182,793
Debt service:					
Principal retirement	107,277	16,675	—	—	123,952
Interest	91,995	11,683	—	—	103,678
Total expenditures	16,572,324	3,989,760	182,793	522,116	21,266,993
Excess revenues over (under) expenditures	2,284,586	(503,830)	(146,696)	162,850	1,796,910
Other Financing Sources (Uses):					
Operating transfers in	295,074	800,176	178,490	18,899	1,292,639
Operating transfers from component units	18,308	951	1,125	—	20,384
Operating transfers out	(511,605)	(790,495)	(5,896)	(16,097)	(1,324,093)
Operating transfers to component units	(2,565,429)	(17,171)	—	(14,577)	(2,597,177)
Proceeds from capital leases	841	—	—	—	841
Proceeds of refunding debt	26,182	—	—	—	26,182
Payment to refunded debt escrow agent	(26,182)	—	—	—	(26,182)
Proceeds from bond sale	—	450,055	—	—	450,055
Total other financing sources (uses)	(2,762,811)	443,516	173,719	(11,775)	(2,157,351)
Excess revenues and other sources over (under) expenditures and other uses	(478,225)	(60,314)	27,023	151,075	(360,441)
Fund balances — July 1 (Note 16)	1,664,787	2,484,437	258,584	2,283,179	6,690,987
Restatements (Note 16)	(953)	52,691	3,506	15,771	71,015
Residual equity transfers in (Note 17)	3,645	441	—	—	4,086
Residual equity transfers out (Note 17)	(44,231)	(21)	(11,686)	—	(55,938)
Increase (decrease) in reserve for related assets	(893)	4,925	—	113	4,145
Fund balances — June 30	$ 1,144,130	$ 2,482,159	$ 277,427	$ 2,450,138	$ 6,353,854

The accompanying Notes to the Financial Statements are an integral part of this statement.

GENERAL FUND AND SPECIAL REVENUE FUNDS
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN UNRESERVED FUND BALANCES — BUDGET AND ACTUAL (BUDGETARY BASIS — NON-GAAP)

For the Fiscal Year Ended June 30, 1999 Exhibit A-3

(Dollars in Thousands)

	General Fund			Special Revenue Funds		
	Final Budget	***Actual***	***Variance-Favorable (Unfavorable)***	***Final Budget***	***Actual***	***Variance-Favorable (Unfavorable)***
Revenues:						
Taxes:						
Individual income	$ 6,358,400	$ 6,606,500	$ 248,100	$ —	$ —	$ —
Corporate income	743,100	848,510	105,410	—	—	—
Sales and use	3,350,000	3,376,207	26,207	—	—	—
Franchise	434,800	409,558	(25,242)	—	—	—
Insurance	273,600	291,231	17,631	—	—	—
Beverage	158,000	158,027	27	—	—	—
Intangibles	—	31	31	—	—	—
Other	271,600	275,201	3,601	—	—	—
Non-Tax:						
Fees, licenses and fines	116,300	120,961	4,661	—	—	—
Investment income	261,500	249,282	(12,218)	—	—	—
Disproportionate share receipts	85,000	85,000	—	—	—	—
Other	133,100	129,814	(3,286)	—	—	—
Transfers in	183,400	183,400	—	—	—	—
Departmental:						
Federal funds	5,700,292	4,900,109	(800,183)	282,248	210,975	(71,273)
Local funds	732,905	636,265	(96,640)	8,561	8,335	(226)
Inter-agency grants and allocations	43,630	9,544	(34,086)	12,307	9,416	(2,891)
Intra-governmental transactions	2,014,543	1,897,439	(117,104)	299,234	252,127	(47,107)
Sales and services	65,234	67,323	2,089	5,950	5,958	8
Sale, rental and lease of property	5,945	5,820	(125)	3,772	4,110	338
Fees, licenses and fines	108,663	110,623	1,960	98,730	79,420	(19,310)
Contributions, gifts and grants	34,142	30,326	(3,816)	466	336	(130)
Miscellaneous	41,471	41,764	293	7,140	5,805	(1,335)
Universities	486,544	473,000	(13,544)	—	—	—
Total Revenues	21,602,169	20,905,935	(696,234)	718,408	576,482	(141,926)
Expenditures:						
Current:						
General government	944,023	916,134	27,889	74,586	67,883	6,703
Education	6,933,574	6,742,929	190,645	—	—	—
Health and human services	9,404,500	8,682,885	721,615	602	589	13
Environment and natural resources	322,830	290,984	31,846	136,122	123,407	12,715
Economic development	182,579	176,255	6,324	349,671	242,629	107,042
Public safety, corrections, and regulation	1,801,562	1,590,220	211,342	200,554	165,681	34,873
Transportation	11,246	11,246	—	—	—	—
Agriculture	82,131	76,456	5,675	—	—	—
Capital outlay	337,200	337,200	—	—	—	—
Debt service	220,382	220,382	—	—	—	—
Universities	2,104,965	2,089,563	15,402	—	—	—
Total Expenditures	22,344,992	21,134,254	1,210,738	761,535	600,189	161,346
Excess revenues over (under) expenditures	(742,823)	(228,319)	514,504	($43,127)	(23,707)	$ 19,420
Transfers from reserves (Note 2D)	227,845	227,845	—		—	
Transfers to reserves (Note 2D)	—	(218,054)	(218,054)		—	
Unreserved fund balances (budgetary basis) at July 1, 1998	515,230	515,230	—		258,441	
Restatements (Note 2B)	—	—	—		(126,517)	
Unreserved fund balances (budgetary basis) at June 30, 1999 (Note 2C)	$ 252	$ 296,702	$ 296,450		$ 108,217	

The accompanying Notes to the Financial Statements are an integral part of this statement.

ALL PROPRIETARY FUND TYPES, SIMILAR TRUST FUNDS, AND DISCRETELY PRESENTED COMPONENT UNITS
COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY

For the Fiscal Year Ended June 30, 1999

(Dollars in Thousands)

	Proprietary Fund Types		*Fiduciary Fund Types*	*TOTAL PRIMARY GOVERNMENT*
	Enterprise	**Internal Service**	**Nonexpendable Trust**	***(Memorandum only)***
Operating Revenues:				
Sales and services	$ 1,235	$ 285,480	$ 995	$ 287,710
Federal funds	—	—	24,505	24,505
Investment earnings	2,509	36,572	10,314	49,395
Interest earnings on loans	—	—	8,852	8,852
Rental and lease earnings	4,086	371	—	4,457
Fees, licenses and fines	7,666	1,011	1,611	10,288
Contributions, gifts and grants	—	70,229	68	70,297
Insurance premiums	6,887	605,326	—	612,213
Miscellaneous	41	1,460	115	1,616
Total operating revenues	22,424	1,000,449	46,460	1,069,333
Operating Expenses:				
Personal services	5,664	54,288	2,215	62,167
Supplies and materials	534	12,002	16	12,552
Services	7,448	94,653	249	102,350
Interest	775	11,743	3,202	15,720
Cost of goods sold	463	36,914	—	37,377
Depreciation/amortization	1,483	32,142	—	33,625
Grants to local governments	—	—	809	809
Claims and benefits	30,390	793,166	—	823,556
Insurance and bonding	2,222	10,060	—	12,282
Other	1,144	35,802	885	37,831
Total operating expenses	50,123	1,080,770	7,376	1,138,269
Operating income (loss)	(27,699)	(80,321)	39,084	(68,936)
Net Nonoperating Revenues (Expenses)	714	550	—	1,264
Income (loss) before operating transfers	(26,985)	(79,771)	39,084	(67,672)
Operating Transfers:				
Transfers in	27,907	3,930	7,432	39,269
Transfers from component units	—	—	—	—
Transfers from primary government	—	—	—	—
Transfers out	(1,281)	(4,255)	(2,279)	(7,815)
Transfers to primary government	—	—	—	—
Total operating transfers in (out)	26,626	(325)	5,153	31,454
Net income (loss)	(359)	(80,096)	44,237	(36,218)
Excess of revenues over (under) expenditures from governmental operations	—	—	—	—
Fund equity — July 1 (Note 16)	68,712	654,433	412,051	1,135,196
Restatements (Note 16)	(1,763)	135	(27)	(1,655)
Increase (decrease) in contributed capital	4,779	904	—	5,683
Fund equity — June 30	$ 71,369	$ 575,376	$ 456,261	$ 1,103,006

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit A-4

Component Units Proprietary Fund Types	*TOTAL REPORTING ENTITY* *(Memorandum only)*
$ 67,685	$ 355,395
—	24,505
34,478	83,873
109,358	118,210
4,683	9,140
2	10,290
—	70,297
—	612,213
8,898	10,514
225,104	1,294,437
65,231	127,398
2,169	14,721
24,603	126,953
94,949	110,669
—	37,377
9,272	42,897
—	809
245	823,801
1,247	13,529
18,134	55,965
215,850	1,354,119
9,254	(59,682)
(84,270)	(83,006)
(75,016)	(142,688)
—	39,269
12,002	12,002
137,787	137,787
—	(7,815)
(52)	(52)
149,737	181,191
74,721	38,503
(148)	(148)
656,643	1,791,839
6,911	5,256
43,471	49,154
$ 781,598	$ 1,884,604

ALL PROPRIETARY FUND TYPES, NONEXPENDABLE TRUST FUNDS, AND DISCRETELY PRESENTED COMPONENT UNITS
COMBINED STATEMENT OF CASH FLOWS

For the Fiscal Year Ended June 30, 1999

(Dollars in Thousands)

	Proprietary Fund Types		*Fiduciary Fund Types*	***TOTAL PRIMARY GOVERNMENT***
	Enterprise	**Internal Service**	**Nonexpendable Trust Funds**	***(Memorandum only)***
Cash Provided From (Used For) Operations:				
Operating income (loss)	$ (27,699)	$ (80,321)	$ 39,084	$ (68,936)
Adjustments to reconcile operating income to net cash flows from operating activities:				
Depreciation/amortization	1,483	32,142	—	33,625
Investment earnings	(2,509)	(36,572)	(10,314)	(49,395)
Securities lending fees	775	11,743	3,202	15,720
Construction projects expensed	—	—	—	—
Mortgage/loan/note principal repayments	—	—	18,695	18,695
Loan sales	—	—	—	—
Mortgages/loans/notes issued	—	—	(25,053)	(25,053)
Mortgage/loan/note cancellation and writeoffs	—	—	—	—
Allowances and uncollectible accounts	—	—	—	—
Restatements and adjustments to cash	(109)	138	(1)	28
Development stage expense	—	—	—	—
Nonoperating miscellaneous income/expense	(304)	1,632	—	1,328
Interest expense	—	—	—	—
(Increases) decreases in assets:				
Receivables	377	(5,741)	(256)	(5,620)
Due from other funds	—	(3,390)	—	(3,390)
Due from component units	—	(172)	—	(172)
Due from primary government	—	—	—	—
Inventories	28	1,154	—	1,182
Prepaid items	(3)	(400)	—	(403)
Increases (decreases) in liabilities:				
Accounts payable and accrued liabilities	510	725	54	1,289
Due to other funds	—	3,727	2	3,729
Due to component units	—	184	—	184
Due to primary government	—	—	—	—
Claims and benefits payable	4,903	8,542	—	13,445
Contracts payable	—	—	—	—
Deposits payable	—	7	—	7
Accrued vacation leave	(22)	(6)	—	(28)
Deferred revenue	949	(189)	—	760
Total cash provided from (used for) operations	(21,621)	(66,797)	25,413	(63,005)
Cash Provided From (Used For) Noncapital Financing Activities:				
Proceeds from sale of bonds/notes	—	—	—	—
Repayment of bond/note principal	—	—	—	—
Interest payments on bonds and notes	—	—	—	—
Bond issuance cost	—	—	—	—
Grants	—	—	—	—
Grants, aid and subsidies	—	—	—	—
Operating transfers in	27,907	3,870	7,432	39,209
Operating transfers from component units	—	—	—	—
Operating transfers from primary government	—	—	—	—
Operating transfers out	(1,281)	(4,255)	(2,279)	(7,815)
Operating transfers to primary government	—	—	—	—
Advance from primary government	—	—	—	—
Nonoperating cash donations	930	—	—	930
Increase in contributed capital	4,779	—	—	4,779
Decrease in contributed capital	—	—	—	—
Long term contract payments	—	—	—	—
Total cash provided from (used for) noncapital financing activities	32,335	(385)	5,153	37,103

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit A-5

Component Units Proprietary Fund Types	***TOTAL REPORTING ENTITY*** *(Memorandum only)*
$ 9,254	$ (59,682)
9,272	42,897
(34,478)	(83,873)
6,069	21,789
3	3
293,561	312,256
2,078	2,078
(484,185)	(509,238)
6,675	6,675
2,268	2,268
(7,685)	(7,657)
(690)	(690)
921	2,249
55,754	55,754
(13,676)	(19,296)
—	(3,390)
—	(172)
(1,037)	(1,037)
48	1,230
(1,583)	(1,986)
10,049	11,338
—	3,729
(113)	71
(2,524)	(2,524)
—	13,445
(166)	(166)
—	7
78	50
1,507	2,267
(148,600)	(211,605)
457,765	457,765
(249,342)	(249,342)
(60,892)	(60,892)
(4,921)	(4,921)
3,590	3,590
(93,891)	(93,891)
—	39,209
12,002	12,002
137,752	137,752
—	(7,815)
(52)	(52)
(33,054)	(33,054)
3,207	4,137
33,599	38,378
(3,893)	(3,893)
219	219
202,089	239,192

Continued

ALL PROPRIETARY FUND TYPES, NONEXPENDABLE TRUST FUNDS, AND DISCRETELY PRESENTED COMPONENT UNITS
COMBINED STATEMENT OF CASH FLOWS (continued)

For the Fiscal Year Ended June 30, 1999

(Dollars in Thousands)

	Proprietary Fund Types		*Fiduciary Fund Types*	***TOTAL PRIMARY GOVERNMENT***
	Enterprise	**Internal Service**	**Nonexpendable Trust Funds**	***(Memorandum only)***
Cash Provided From (Used For) Capital Financing Activities:				
Acquisition of fixed assets	(300)	(50,128)	—	(50,428)
Proceeds from the sale of fixed assets	—	2,978	—	2,978
Proceeds from sale of bonds/notes	—	—	—	—
Repayment of bond/note principal	(130)	—	—	(130)
Interest payments on bonds, notes and capital leases	(4)	—	—	(4)
Capital grants	—	—	—	—
Principal payment on capital leases	—	—	—	—
Transfer from primary government	—	—	—	—
Dredging costs	—	—	—	—
Total cash provided from (used for) capital financing activities	(434)	(47,150)	—	(47,584)
Cash Provided From (Used For) Investment Activities:				
Proceeds from the sale/maturities of non-State Treasurer investments	754	200	386	1,340
Redemptions from the State Treasurer Long-Term Investment Portfolio	—	1,700	2,120	3,820
Purchase of non-State Treasurer investments	(1,585)	—	(375)	(1,960)
Purchase into State Treasurer Long-Term Investment Portfolio	—	(3,000)	(1,391)	(4,391)
Investment earnings	1,580	21,426	6,452	29,458
Total cash provided from (used for) investment activities	749	20,326	7,192	28,267
Net increase (decrease) in cash and cash equivalents	11,029	(94,006)	37,758	(45,219)
Deficit from governmental operations	—	—	—	—
Cash and cash equivalents at July 1	29,123	420,441	107,733	557,297
Cash and cash equivalents at June 30	$ 40,152	$ 326,435	$ 145,491	$ 512,078
Noncash Investing, Capital, and Financing Activities:				
Noncash distributions (loss) from the State Treasurer Long-Term Investment Portfolio	187	$ 3,914	$ (12)	$ 4,089
Increase in contributed capital	—	1,046	—	1,046
Decrease in contributed capital	—	(142)	—	(142)
Assets acquired through the assumption of a liability	19,919	197,313	82,271	299,503
Interest expense on advance from primary government	—	—	—	—

Cash and cash equivalents in the Fiduciary Fund Types on the Combined Balance Sheet include:

Expendable Trust Funds	$ 268,477
Nonexpendable Trust Funds	145,491
Pension Trust Funds	252,143
Investment Trust Fund	32,240
Agency Funds	669,326
Total	$ 1,367,677

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit A-5

Component Units Proprietary Fund Types	***TOTAL REPORTING ENTITY*** *(Memorandum only)*
(25,332)	(75,760)
49	3,027
533	533
(1,574)	(1,704)
(545)	(549)
18,030	18,030
(1,115)	(1,115)
35	35
(391)	(391)
(10,310)	(57,894)
748,452	749,792
—	3,820
(797,494)	(799,454)
—	(4,391)
31,953	61,411
(17,089)	11,178
26,090	(19,129)
148	148
209,963	767,260
$ 236,201	$ 748,279
$ 7,720	$ 11,809
—	1,046
—	(142)
15,612	315,115
3,088	3,088

PENSION TRUST FUNDS
COMBINING STATEMENT OF PLAN NET ASSETS
ALL PENSION PLANS

June 30, 1999 *Exhibit A-6*

(Dollars in Thousands)

	Teachers' and State Employees' Retirement System	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund	Local Governmental Employees' Retirement System	401(k) Supplemental Retirement Income Plan	*Totals*
ASSETS								
Cash and cash equivalents....	$ 74,778	$ 1,049	$ 209	$ 1,402	$ 196	$ 8,188	$ 166,321	$ 252,143
Investments (Note 9, 10):								
Bank investment contracts.	—	—	—	—	—	—	322,715	322,715
Mutual funds.....................	—	—	—	—	—	—	1,281,367	1,281,367
State Treasurer investment pool..............	45,075,043	334,264	26,090	250,169	46,356	11,283,396	—	57,015,318
Receivables:								
Accounts receivable...........	274	—	—	—	—	319	—	593
Interest receivable............	609	8	2	1	1	358	387	1,366
Contributions receivable....	92,350	827	94	—	—	25,782	10,603	129,656
Notes receivable...................	—	—	—	—	—	—	89,125	89,125
Total Assets..........................	45,243,054	336,148	26,395	251,572	46,553	11,318,043	1,870,518	59,092,283
LIABILITIES								
Obligations under securities lending.............	2,190,492	16,622	1,461	12,887	2,433	550,563	—	2,774,458
Refunds and other payables	—	—	—	—	—	—	2,021	2,021
Due to other funds (Note 8)...	—	—	—	1	—	—	—	1
Benefits payable...................	43,503	—	—	—	—	97	—	43,600
Total Liabilities......................	2,233,995	16,622	1,461	12,888	2,433	550,660	2,021	2,820,080
FUND BALANCE								
Reserved for employees' pension benefits (Note 15).	$ 43,009,059	$ 319,526	$ 24,934	$ 238,684	$ 44,120	$ 10,767,383	$ 1,868,497	$ 56,272,203

A schedule of funding progress for each defined benefit plan is presented on page 116 .

The accompanying Notes to the Financial Statements are an integral part of this statement.

PENSION TRUST FUNDS
COMBINING STATEMENT OF CHANGES IN PLAN NET ASSETS
ALL PENSION PLANS

For the Fiscal Year Ended June 30, 1999 *Exhibit A-7*

(Dollars in Thousands)

	Teachers' and State Employees' Retirement System	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund	Local Governmental Employees' Retirement System	401(k) Supplemental Retirement Income Plan	*Totals*
Additions:								
Contributions:								
Employer	$ 637,825	$ 7,304	$ 807	$ —	$ —	$ 158,157	$ 67,550	$ 871,643
Plan members	527,618	2,633	272	2,923	—	191,068	121,130	845,644
Other contributions	—	—	—	12,105	2,533	—	—	14,638
Total contributions	1,165,443	9,937	1,079	15,028	2,533	349,225	188,680	1,731,925
Investment Income:								
Investment earnings	4,406,587	32,577	2,455	24,148	4,322	1,093,235	279,105	5,842,429
Less investment expenses	(154,035)	(1,164)	(96)	(850)	(163)	(39,801)	—	(196,109)
Net investment income	4,252,552	31,413	2,359	23,298	4,159	1,053,434	279,105	5,646,320
Fees, licenses and fines	—	—	—	—	—	4,542	1,757	6,299
Interest earnings on loans	—	—	—	—	—	—	7,396	7,396
Miscellaneous additions	1,388	—	—	3	—	23	—	1,414
Total additions	5,419,383	41,350	3,438	38,329	6,692	1,407,224	476,938	7,393,354
Deductions:								
Administrative expense	5,818	65	7	479	25	2,058	5,494	13,946
Benefits	1,382,933	12,431	991	13,084	1,775	296,775	72,717	1,780,706
Refund of contributions	75,734	21	19	349	—	54,825	—	130,948
Total deductions	1,464,485	12,517	1,017	13,912	1,800	353,658	78,211	1,925,600
Net increase (decrease)	3,954,898	28,833	2,421	24,417	4,892	1,053,566	398,727	5,467,754
Fund balance reserved for employees' pension benefits								
Beginning of the year (Note 16)	39,054,161	290,693	22,513	214,267	39,228	9,713,817	1,469,770	50,804,449
End of year	$ 43,009,059	$ 319,526	$ 24,934	$ 238,684	$ 44,120	$ 10,767,383	$ 1,868,497	$56,272,203

The accompanying Notes to the Financial Statements are an integral part of this statement.

INVESTMENT TRUST FUND
STATEMENT OF NET ASSETS

June 30, 1999 *Exhibit A-8*

(Dollars in Thousands)

	Investment Trust Fund
ASSETS	
Cash and cash equivalents	$ 32,240
Investments	1,127,040
Receivables:	
Interest receivable	10,278
Total Assets	1,169,558
LIABILITIES	
Obligations under securities lending	420,003
Distributions payable	3,550
Total Liabilities	423,553
NET ASSETS	
Held in trust for pool participants	$ 746,005

The accompanying Notes to the Financial Statements are an integral part of this statement.

INVESTMENT TRUST FUND
STATEMENT OF CHANGES IN NET ASSETS

For the Fiscal Year Ended June 30, 1999 *Exhibit A-9*

(Dollars in Thousands)

	Investment Trust Fund
Net increase in net assets resulting from operations:	
Revenues	
Investment income	$ 55,377
Expenses	
Investment expenses	17,019
Net increase in net assets resulting from operations	38,358
Distributions to participants:	
Distributions paid and payable	(38,358)
Share transactions:	
Reinvestment of distributions	36,281
Net share purchases/(redemptions)	367,310
Total increase in net assets	403,591
Net assets:	
Beginning of the year (Note 16)	306,610
Restatement	35,804
End of the year	$ 746,005

The accompanying Notes to the Financial Statements are an integral part of this statement.

COMPONENT UNITS — COLLEGE AND UNIVERSITY FUNDS
COMBINED STATEMENT OF CHANGES IN FUND EQUITY

For the Fiscal Year Ended June 30, 1999 *Exhibit A-10*

(Dollars in Thousands)

Revenues and Other Additions:	
Tuition and fees	$ 420,479
Federal appropriations	23,397
County appropriations	118,719
Federal contracts and grants	661,166
State contracts and grants	97,362
Local contracts and grants	24,431
Private gifts, contracts and grants	307,478
Endowment income	24,409
Sales and services	874,424
Investment earnings	135,764
Expended for plant facilities	454,241
Retirement of indebtedness	33,896
Proceeds of refunding debt	9,032
Income from hospital operations	436,671
Other revenues and additions	59,196
Total Revenues and Other Additions	3,680,665
Expenditures and Other Deductions:	
Educational and general	3,662,845
Auxiliary enterprises	506,336
Internal service	33,952
Independent operations	13,047
Professional clinical services	207,222
Indirect cost recovered	94,259
Refunded to grantors	1,389
Administrative and collection costs, loan cancellation and bad debts	2,998
Expended for plant facilities	364,123
Retirement of indebtedness	33,816
Payment to escrow agent	8,776
Interest on indebtedness	37,693
Disposal of plant facilities	87,053
Loss on refunding of debt	543
Hospital operations	436,549
Other expenditures and deductions	6,883
Total Expenditures and Other Deductions	5,497,484
Transfers-Additions (Deductions):	
Operating transfers from primary government	2,452,457
Operating transfers to primary government	(20,332)
Operating transfers to component units	(12,002)
Net transfers	2,420,123
Net increase in fund equity	603,304
Fund equity — July 1 (Note 16)	7,846,547
Restatements (Note 16)	109,301
Residual equity transfers out (Note 17)	(91)
Fund equity — June 30	$ 8,559,061

The accompanying Notes to the Financial Statements are an integral part of this statement.

COMPONENT UNITS — COLLEGE AND UNIVERSITY FUNDS
COMBINED STATEMENT OF CURRENT FUNDS
REVENUES, EXPENDITURES AND TRANSFERS

For the Fiscal Year Ended June 30, 1999 *Exhibit A-11*

(Dollars in Thousands)

Revenues:	
Tuition and fees	$ 419,142
Federal appropriations	23,397
County appropriations	100,410
Federal contracts and grants	574,409
State contracts and grants	88,286
Local contracts and grants	97,317
Private gifts, contracts and grants	153,988
Endowment income	16,373
Sales and services	874,396
Investment earnings	61,058
Other revenues	39,872
Total Current Revenues	2,448,648
Expenditures:	
Educational and general:	
Instruction	1,615,176
Organized research	393,170
Public service	261,231
Academic support	269,915
Student services	134,670
Institutional support	393,894
Physical plant operations	281,003
Student financial aid	313,786
Total educational and general	3,662,845
Auxiliary enterprises	506,336
Internal service	33,952
Independent operations	13,047
Professional clinical services	207,222
Total Expenditures	4,423,402
Transfers and Additions (Deductions):	
Excess of restricted receipts over revenues earned	11,971
Refund to grantors	(1,354)
Mandatory transfers	(61,877)
Non-mandatory transfers	(41,700)
Interinstitutional transfers	(2,338)
Operating transfers from primary government	2,186,021
Operating transfers to primary government	(1,549)
Operating transfers to component units	(12,002)
Net increase in fund equity	$ 102,418

The accompanying Notes to the Financial Statements are an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS

INDEX

DETAIL NOTES ON ALL FUNDS AND ACCOUNT GROUPS

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The accompanying financial statements of the State of North Carolina financial reporting entity have been prepared in conformity with generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board (GASB), which consist of GASB Statements and Interpretations, as well as American Institute of Certified Public Accountants (AICPA) and Financial Accounting Standards Board (FASB) pronouncements specifically made applicable to state and local governmental entities by GASB Statements and Interpretations. In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the State does not apply FASB pronouncements issued after November 30, 1989 for proprietary activities, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date. The financial statements of the college and university funds have been prepared in conformity with generally accepted accounting principles for colleges and universities as prescribed by GASB Statement No. 15, *Governmental College and University Accounting and Financial Reporting Models*. The financial statements of the North Carolina Railroad Company (Railroad), a for-profit corporation (*discretely presented proprietary component unit*), have been prepared based on FASB pronouncements. The Railroad's financial statements have been incorporated into the State's reporting entity based on the definition and display provisions of GASB Statement No. 14, *The Financial Reporting Entity*.

The financial statements are presented as of and for the fiscal year ended June 30, 1999, except for the USS North Carolina Battleship Commission whose statements are as of and for the fiscal year ended September 30, 1998, and the North Carolina Deferred Compensation Plan, the 401(k) Supplemental Retirement Income Plan, and the North Carolina Railroad Company whose statements are as of and for the fiscal year ended December 31, 1998. Occupational licensing boards have financial statements with various fiscal year ending dates.

B. Financial Reporting Entity

The financial reporting entity includes (1) the primary government, (2) organizations for which the primary government is financially accountable, and (3) organizations for which the nature and significance of their relationships with the primary government are such that exclusion would cause the primary government's financial statements to be misleading or incomplete.

The State of North Carolina, as primary government, consists of all organizations that make up its legal entity. All funds, organizations, agencies, boards, commissions, and authorities that are not legally separate are, for financial reporting purposes, part of the primary government. The primary government has a separately elected governing body (the General Assembly) and the primary government must be both legally separate and fiscally independent. Component units are legally separate entities for which the State is financially accountable. Accountability is defined as the State's substantive appointment of a majority of the component unit's governing board. Furthermore, the State must be able to impose its will upon the component unit or there must be a possibility that the component unit may provide specific benefits to, or impose specific financial burdens on, the State. The State has applied the criteria outlined in GASB Statement No. 14, *The Financial Reporting Entity*, in determining financial accountability.

As required by generally accepted accounting principles, these financial statements present the State (the primary government) and its component units. The component units are included in the financial reporting entity because of the significance of their operational or financial relationships with the State, as described below.

Blended Component Units

Comprehensive Major Medical Plan

The Comprehensive Major Medical Plan (Plan) is a component unit that provides medical benefits to employees and retirees of the State, most of its component units, and local boards of education that are not part of the reporting entity. The Plan has corporate powers and is governed by a board whose members are appointed by either the Governor or the General Assembly. Provisions and contribution rates are approved by the General Assembly, with the State making significant contributions as an employer and through its funding of local boards of education. The Plan has been included in the financial statements using the blending method (internal service fund) because it almost exclusively benefits the primary government. Even though a substantial number of covered participants are not employees of the primary government, the Plan essentially serves only the primary government by managing the risk associated with providing health insurance to eligible employees. The other employers in the Plan do not have risk since the primary government is responsible for funding the premiums of all covered employees.

Disability Income Plan of North Carolina

The Disability Income Plan of North Carolina (Plan) is a component unit that provides disability benefits to employees of the State, most of its component units, and local boards of education that are not part of the reporting entity. The Plan has corporate powers and is governed by a fourteen-member board. Ten members are appointed by the Governor, two are appointed by the General Assembly, and two are elected State officials. Provisions and contribution rates are approved by the General Assembly, with the State making significant contributions as an employer and through its funding of local boards of education. The Plan has been included in the financial statements using the blending method (internal service fund) because it almost exclusively benefits the primary government. Even though a substantial number of covered participants are not employees of the primary government, the Plan essentially serves only the primary government by managing the risk associated with providing disability insurance to eligible employees. The other employers in the Plan do not have risk since the primary government is responsible for funding the premiums of all covered employees.

Discretely Presented Component Units

The component units columns in the combined financial statements include the financial data of the following organizations. They are reported as either college and university funds or proprietary funds.

College and University Funds

University of North Carolina System

The Board of Governors of the consolidated University of North Carolina (UNC) system is a legally separate body, composed of thirty-two members elected by the General Assembly. The Board of Governors establishes system-wide administrative policies while budgetary decisions are exercised at the State level. Within the consolidated system there is UNC-General Administration, which is the administrative arm of the Board of Governors, the sixteen constituent universities, and UNC Hospitals. Each of the sixteen universities, in turn, is governed by its own separate board of trustees that is responsible for the operations of that campus only. UNC Hospitals is governed by a separate board of directors. Funding for each of the institutions of the UNC system is accomplished by State appropriations, tuition and fees, sales and services, federal grants, and private donations and grants.

The following constituent institutions comprise the UNC system for financial reporting purposes:

Appalachian State University
East Carolina University
Elizabeth City State University
Fayetteville State University
North Carolina Agricultural and Technical State University
North Carolina Central University
North Carolina School of the Arts
North Carolina State University
University of North Carolina at Asheville
University of North Carolina at Chapel Hill
University of North Carolina at Charlotte
University of North Carolina at Greensboro
University of North Carolina at Pembroke
University of North Carolina at Wilmington
Western Carolina University
Winston-Salem State University
UNC Hospitals

Community Colleges

There are currently fifty-eight community colleges located throughout the State of North Carolina. Each is a separate component unit of the reporting entity and is legally separate. The State does not appoint a voting majority of each community college board of trustees. The State Board of Community Colleges (the Board) approves the budgeting of state and federal funds, the associated budget revisions, and the selection of the chief administrative officer of each individual community college. The Board is comprised of state officials or their appointees. Each community college is similar in nature and function to all of the others, and the operations of no community college is considered major in relation to the operations of all community colleges in the system. Therefore, aggregated financial information is presented in this CAFR for all community colleges. The following are the State's fifty-eight community colleges:

Alamance Comm. College	Anson Comm. College
Asheville-Buncombe Technical Comm. College	Beaufort County Comm. College
Bladen Community College	Blue Ridge Comm. College
Brunswick Comm. College	Caldwell Comm. College and Technical Institute
Cape Fear Comm. College	Carteret Comm. College
Catawba Valley Comm. College	Central Piedmont Comm. College
Central Carolina Comm. College	Cleveland Comm. College
Coastal Carolina Comm. College	College of The Albemarle
Craven Comm. College	Durham Technical Comm. College
Davidson County Comm. College	Fayetteville Technical Comm. College
Edgecombe Comm. College	Forsyth Technical Comm. College
Gaston College	Guilford Technical Comm. College
Halifax Comm. College	Haywood Comm. College
Isothermal Comm. College	James Sprunt Comm. College
Johnston Comm. College	Lenoir Comm. College
Martin Comm. College	Mayland Comm. College
McDowell Technical Comm. College	Mitchell Comm. College
Montgomery Comm. College	Nash Comm. College
Pamlico Comm. College	Piedmont Comm. College
Pitt Comm. College	Randolph Comm. College
Richmond Comm. College	Roanoke-Chowan Comm. College
Robeson Comm. College	Rockingham Comm. College
Rowan-Cabarrus Comm. College	Sampson Comm. College
Sandhills Comm. College	Southeastern Comm. College
Southwestern Comm. College	Stanly Comm. College
Surry Comm. College	Tri-County Comm. College
Vance-Granville Comm. College	Wake Technical Comm. College
Wayne Comm. College	Western Piedmont Comm. College
Wilkes Comm. College	Wilson Technical Comm. College

Proprietary Funds

North Carolina Housing Finance Agency

The North Carolina Housing Finance Agency is a legally separate organization established to administer programs to finance construction of low and moderate income housing. The Agency has a thirteen-member board of directors, with twelve appointed by either the Governor or the General Assembly. The thirteenth member is elected by the other twelve. The State can significantly influence the programs, projects, activities, and level of services of the Agency.

State Education Assistance Authority

The State Education Assistance Authority is a legally separate authority created to provide a system of financial assistance, consisting of grants, loans, work-study or other employment, and other aids, to qualified students to obtain an education beyond the high school level by attending public or private educational institutions. The Authority is governed by a seven-member board of directors, all of whom are appointed by the Governor. The State provides significant operating subsidies to the Authority; therefore, a financial benefit/burden relationship exists between the State and the Authority.

North Carolina State Ports Authority

The North Carolina State Ports Authority is a legally separate authority established to operate the State's port facilities in Wilmington and Morehead City. It is governed by an eleven-member board, all of whom are appointed by either the Governor or the General Assembly. A financial benefit/burden relationship exists between the State and the Authority.

North Carolina Railroad Company

The North Carolina Railroad Company is a legally separate, for-profit corporation owned by the State for the purpose of promoting trade, industry, and transportation within the State of North Carolina and advancing the economic interests of the State. The Railroad is governed by a 14 member board, all of whom are elected by shares held by the State. A financial benefit/burden relationship exists between the State and the Railroad.

North Carolina Global TransPark Authority

The North Carolina Global TransPark Authority (formerly North Carolina Air Cargo Airport Authority) is a legally separate authority created to administer the development of the North Carolina Global TransPark. Of the twenty-member governing board, nineteen are voting members. Seven of the voting members are appointed by the Governor and six are appointed by the General Assembly. The State has obligated itself to provide significant funding to the Authority for years to come; therefore, a financial benefit/ burden relationship exists between the State and the Authority.

North Carolina Low Level Radioactive Waste Management Authority

The North Carolina Low Level Radioactive Waste Management Authority is a legally separate authority created to locate, construct and operate a regional site for the disposal of low level radioactive waste. The Authority is governed by a fifteen-member board, all of whom are appointed by either the Governor or the General Assembly. The State has the ability to influence the budget, programs, and activities of the Authority.

MCNC

MCNC (formerly the Microelectronics Center of North Carolina) is a legally separate nonprofit corporation created to foster advanced programs in microelectronics and supercomputing, in support of economic development and of North Carolina universities and research institutes. Of the sixteen-member governing board, eleven are voting members. Seven of the voting board members are appointed by the Governor and four serve as a result of their positions with the UNC system, a component unit of the State. The State has provided significant funding to the organization since its inception; therefore, a financial benefit/burden relationship exists between the State and the organization.

North Carolina Biotechnology Center

The North Carolina Biotechnology Center is a legally separate nonprofit corporation created to further economic development through the support of biotechnology research. The Center is governed by a thirty-five-member board. Fifteen of the board members are appointed by the Governor or General Assembly and four serve as a result of their positions with the UNC system, a component unit of the State. The State has provided significant funding to the Center since its inception; therefore, a financial benefit/burden relationship exists between the State and the Center.

North Carolina Rural Economic Development Center, Inc.

The North Carolina Rural Economic Development Center is a legally separate organization established to build economic strength in the State’s 85 rural counties, with a special focus on creation of economic opportunities for citizens with low to moderate incomes. The Center has a 48 member board of directors, with three appointed by the Governor, three by the Lieutenant Governor, and three by the Speaker of the House. The other members are elected by the appointed members of the board of directors. The State provides significant program and operating support to the Center creating a benefit/burden relationship.

North Carolina Agricultural Finance Authority

The North Carolina Agricultural Finance Authority is a legally separate authority created to administer the financing of low-interest loans to farmers. The Authority is governed by a ten-member board, one of whom is a state official and nine of whom are appointed by either the Governor or the General Assembly. A financial benefit/burden relationship exists between the State and the Authority.

North Carolina Partnership for Children, Inc.

The North Carolina Partnership for Children, Inc., is a legally separate organization established to develop a comprehensive long-range strategic plan for early childhood development. A thirty-three-member board governs the Partnership. Certain elected state officials appoint twenty-nine of the members, while four members serve ex officio by virtue of their state positions. The State provides significant operating subsidies to the Partnership creating a benefit/burden relationship.

North Carolina Ports Railway Commission

The North Carolina Ports Railway Commission is a legally separate organization established to operate, maintain and control all railway equipment and railway operations transferred to it by the North Carolina State Ports Authority in January 1981. The Commission is governed by a five-member board, all of whom are appointed by the Governor. A financial benefit/burden relationship exists between the State and the Commission.

North Carolina Rural Rehabilitation Corporation

The North Carolina Rural Rehabilitation Corporation is a legally separate nonprofit corporation created to assist individuals and families in rural areas of the state. The Corporation is governed by a nine-member board, all of whom are appointed by the Governor or serve by virtue of their positions as state officials. The State has the ability to influence the budget, programs, and activities of the Corporation.

North Carolina Regional Economic Development Commissions:

Northeastern North Carolina Regional Economic Development Commission

The Northeastern North Carolina Regional Economic Development Commission is a legally separate organization created to facilitate economic development and tourism in northeastern North Carolina. The Commission consists of 17 members, including the Secretary of Commerce and the Secretary of the Department of Environment and Natural Resources (or their designees), five members appointed by the Governor, five by the Speaker of the House, and five by the President Pro Tempore of the Senate. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

Southeastern North Carolina Regional Economic Development Commission

The Southeastern North Carolina Regional Economic Development Commission is a legally separate organization created to build economic strength in southeastern North Carolina. The Commission consists of 15 members, with three appointed by the Governor, two by the Lieutenant Governor, five by the Speaker of the House, and five by the President Pro Tempore of the Senate. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

Western North Carolina Regional Economic Development Commission

The Western North Carolina Regional Economic Development Commission is a legally separate organization created to improve economic opportunity in western North Carolina with sensitivity to the resources of that region. The Commission consists of 15 members, with five appointed by the N.C. House of Representatives, five by the N.C. Senate, three by the Governor, and two by the Lieutenant Governor. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

Complete financial statements for the following component units can be obtained from the Office of the State Auditor, 2 South Salisbury Street, 20601 Mail Service Center, Raleigh, N.C. 27699-0601.

University of North Carolina System
Community colleges
North Carolina State Ports Authority
North Carolina Global TransPark Authority
North Carolina Low Level Radioactive Waste Management Authority
North Carolina Partnership for Children, Inc.
North Carolina Ports Railway Commission

Complete financial statements of the remaining component units, examined by independent auditors, can be obtained from the respective administrative offices of those units, listed below:

N.C. Housing Finance Agency
P.O. Box 28066
Raleigh, NC 27611-8066

MCNC
P.O. Box 12889
Research Triangle Park, NC 27709-2889

State Education Assistance Authority
P.O. Box 2688
Chapel Hill, NC 27515-2688

North Carolina Railroad Company
3200 Atlantic Avenue, Suite 110
Raleigh, NC 27604-1640

Western N.C. Regional Economic Development Commission
P.O. Box 1258
Arden, NC 28704

N.C. Rural Economic Development Center, Inc.
4021 Carya Drive
Raleigh, NC 27610

Northeastern N.C. Regional Economic Development Commission
P.O. Box 29
Edenton, NC 27932

Southeastern N.C. Regional Economic Development Commission
P.O. Box 2556
Elizabethtown, NC 28337

N.C. Biotechnology Center
P.O. Box 13547
Research Triangle Park, NC 27709-3547

The North Carolina Agricultural Finance Authority and the North Carolina Rural Rehabilitation Corporation do not issue separate financial statements.

C. Fund Accounting

The financial activities of the State and its component units are organized on a basis of individual funds and account groups, each of which is a separate accounting entity segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with specific regulations, restrictions, or limitations. The financial activities of the State and its component units accounted for in the accompanying financial statements have been classified into the following fund categories and account groups:

NOTES TO THE FINANCIAL STATEMENTS

1. Primary Government (the State)

Governmental Funds

Governmental funds are those through which most governmental functions of the State are financed. The acquisition, use, and balances of the primary government's expendable financial resources and the related liabilities (except those accounted for in proprietary funds) are accounted for through governmental funds. The measurement focus is upon determination of financial position and changes in financial position (sources, uses, and balances of financial resources) rather than upon net income determination. The following are the State's governmental funds.

General Fund

All financial resources received and used for services traditionally provided by a state government and not required to be accounted for in other funds are accounted for in the General Fund. These services include general government; education (other than universities and community colleges); health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; and agriculture.

Special Revenue Funds

Transactions related to resources obtained from specific revenue sources (other than for expendable trusts or major capital projects) that are legally restricted to expenditures for specific purposes are accounted for in special revenue funds. The special revenue funds reported in this CAFR have been grouped under the following governmental functional categories: transportation; general government; education (other than universities and community colleges); health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; and agriculture.

Capital Projects Funds

Transactions related to resources obtained and used for the acquisition, construction, or improvement of major governmental general fixed assets are accounted for in the capital projects funds. Such resources are derived principally from operating transfers from the General Fund and from bond funds. Highway infrastructure construction projects are accounted for in the State Highway Fund and the Highway Trust Fund. These projects are not included in the capital projects funds.

Proprietary Funds

Proprietary funds are used to account for the State's ongoing activities which are similar to those often found in the private sector. The measurement focus is upon determination of net income, financial position, and changes in cash flows. The generally accepted accounting principles used are those applicable to similar businesses in the private sector; thus, these funds are reported on the accrual basis of accounting. The following are the State's proprietary funds.

Enterprise Funds

Enterprise funds account for operations of the State that are financed and operated in a manner similar to private business enterprises. The costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are financed or recovered primarily through user charges. The acquisition, maintenance, and improvement of physical plant facilities required to provide these goods and services are financed from existing cash resources, the issuance of bonds, federal grants, and other State funds.

Internal Service Funds

Internal service funds account for the operations of State agencies that provide services to other State agencies, departments, or other governmental units on a cost reimbursement basis.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations, other governmental units, and/or other funds. The following are the primary government's fiduciary funds.

Trust Funds

- **Expendable Trust —** Expendable trust funds account for assets held by the State in a trustee capacity where the principal and income may be expended in the course of the funds' designated operations.

- **Nonexpendable Trust —** Nonexpendable trust funds account for assets held by the State in a trustee capacity where only income derived from the principal may be expended in the course of the funds' designated operations. The principal must be preserved intact.

- **Pension Trust —** Pension trust funds account for transactions, assets, liabilities, and net assets available for plan benefits of the various State and local governmental public employee retirement systems which the State administers.

- **Investment Trust —** The investment trust fund accounts for the external portion of the Investment Pool sponsored by the State Treasurer.

Agency Funds

Agency funds account for the various taxes, deposits, deductions, and property collected by the State, acting in the capacity of an agent, for distribution to other governmental units or designated beneficiaries.

Account Groups

Account groups are used to establish accounting control and accountability for the State's general fixed assets and general long-term obligations and do not involve measurement of operations.

General Fixed Assets Account Group

This account group is established to account for fixed assets acquired for general government purposes, except those accounted for in proprietary funds or college and university funds. General fixed assets do not represent financial resources available for appropriation and expenditure.

General Long-Term Obligations Account Group.

This account group is established to account for the unmatured principal of the State's general long-term debt and other long-term obligations of governmental funds. The unmatured principal of general long-term debt and other long-term obligations does not require current appropriation and expenditure of governmental fund financial resources.

2. Component Units

Proprietary Funds

Proprietary funds are used to account for the various component units' ongoing activities which are similar to those often found in the private sector, as well as those within the primary government described above.

College and University Funds

College and university funds account for the operations of the UNC system and community colleges in accordance with existing authoritative accounting and reporting principles applicable to colleges and universities. Presentation of the underlying fund groups of the individual universities and community colleges is available from each respective institution's separately issued financial statements.

D. Basis of Accounting

The basis of accounting determines when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds and expendable trust funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are generally included on the balance sheet. Operating statements of these funds present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

All proprietary funds, nonexpendable trust, and pension trust funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of proprietary funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings. Proprietary funds' and similar trust funds' operating statements present increases (revenues) and decreases (expenses) in net total assets.

1. Governmental Funds, Expendable Trust Funds and Agency Funds

The accounts of the general, special revenue, capital projects, expendable trust, and agency funds are reported using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period in which they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at fiscal year-end. The State considers amounts to be available if due within 31 days of the close of the fiscal year. Expenditures and other uses of financial resources are recognized when the related liability is incurred, except for items that are not planned to be liquidated with expendable available resources, such as the long-term portion of the liability for compensated absences and capital lease obligations.

Other modifications to the accrual basis of accounting include the following:

- inventories generally are considered expenditures at acquisition;
- prepayments usually are not capitalized; and
- principal and interest on long-term debt are recorded when due.

2. Proprietary Funds, Nonexpendable Trust Funds and Pension Trust Funds

The accounts of the enterprise, internal service, nonexpendable trust, pension trust funds, and proprietary component units are reported using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

3. College and University Funds

The accounts of the college and university funds are reported using the accrual basis of accounting with the following exceptions:

- Depreciation expense related to plant fund assets is not recorded; and
- Revenues and expenditures of an academic term encompassing more than one fiscal year are reported solely in the fiscal year in which the program is predominantly conducted.

E. Cash and Cash Equivalents

This classification appears on the accompanying combined balance sheet, combining statement of pension plan net assets, investment trust fund statement of net assets, and combined statement of cash flows. It includes deposits held by the State Treasurer in the short-term investment portfolio more fully discussed in Note 4, investment of bond proceeds, demand deposits with private financial institutions, and cash on hand. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and also may withdraw cash at any time without prior notice or penalty. Bond proceeds are invested in highly liquid securities with an original maturity of 3 months or less.

F. Investments

This classification includes deposits held by the State Treasurer in certain long-term investment portfolios more fully discussed in Note 4 as well as investments held separately by the State and its component units. It also includes each participating fund and component unit’s share of the cash collateral received and invested by the State Treasurer under securities lending agreements. During the year the State reassessed which funds and component units bear the risk of loss on the collateral assets. This significantly affected the assets and liabilities reported by the individual funds and component units. Investments are generally valued at fair value. Additional investment valuation information is provided in Note 4.

The classification does not include any of the reporting entity's accounts that would be defined as cash equivalents based on GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

G. Deposit with Federal Government

This classification consists of unemployment compensation trust funds (expendable trust fund) held on deposit in the Federal Reserve Bank of the United States Treasury.

H. Receivables and Due from Other Funds

Receivables in governmental and fiduciary funds consist primarily of tax, interest, and federal revenues. Receivables in proprietary and college and university funds occur in the normal course of business. The “Due from other funds” classification represents interfund receivables consisting of transactions between fund types within the State (primary government). Operating transfers, quasi-external transactions, and reimbursements are classified in this account. All receivables are shown net of allowances for doubtful accounts.

I. Advances to Other Funds

Noncurrent portions of long-term interfund loan receivables are reported as advances and are offset by a fund balance reserve account which indicates that they do not constitute expendable available financial resources and therefore are not available for appropriation.

J. Inventories

The inventories of the State and proprietary component units are valued on the first-in, first-out, last invoice cost, or average cost basis. These inventories consist of general supplies and materials. Institutions of the UNC system and community colleges also use these valuations along with the retail inventory method for some bookstore operations. The State Highway Fund (special revenue fund) accounts for its maintenance and construction inventories using the average cost basis. Inventories of all proprietary funds are valued by the first-in, first-out method or average cost basis.

Except for the State Highway Fund's maintenance and construction inventories, the cost of inventory items in the State's governmental funds is recorded as an expenditure when purchased. Reported inventories are equally offset by a fund balance reserve that indicates they do not constitute "available spendable resources" even though they are a part of net current assets. All other inventories of the State and its component units are recognized as expenses or expenditures when consumed.

K. Food Stamps

In accordance with GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, the State recognizes distributions of food stamp benefits as revenue and expenditures in the general fund, whether the benefits are distributed directly or through agents and whether the benefits are in paper or electronic form. Expenditures are recognized when the benefits are distributed to the individual recipients by the State or its agents; revenue is recognized at the same time. The State reports food stamp balances held by the State or by its agents at the balance sheet date as an asset offset by deferred revenue. Revenue, expenditures, and balances of food stamps are measured based on face value.

L. Fixed Assets

General fixed assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions and construction are reflected as expenditures in governmental funds, and the related assets are reported in the general fixed assets account group. For financial reporting purposes, depreciation is not recorded on general fixed assets. Fixed assets of all proprietary funds are capitalized in the fund in which they are utilized and are depreciated either on the straight-line basis or on the units of output basis over their useful lives. Fixed assets of the UNC system and community colleges are capitalized in college and university funds. Depreciation is not reported on these assets.

Fixed assets are stated at historical cost, or in some instances, estimated historical cost. Donated fixed assets are stated at fair market value at the time of donation. The State (except for the USS N.C. Battleship Commission), some proprietary component units, and the college and university component units capitalize all fixed assets that have a value or cost greater than or equal to $5,000 at the date of acquisition and have an expected useful life of two or more years. Certain proprietary component units (N.C. Housing Finance Agency, N.C. State Ports Authority, N.C. Railroad Company, N.C. Global TransPark Authority, N.C. Biotechnology Center, N.C. Partnership for Children, Northeastern N.C. Regional Economic Development Commission, Southeastern N.C. Regional Economic Development Commission, Western N.C. Regional Economic Development Commission, N.C. Rural Economic Development Center) and the USS N.C. Battleship Commission (an enterprise fund) maintain a minimum threshold of $500.

Occupational licensing boards use various thresholds to capitalize fixed assets.

The value of assets constructed by the State and its component units for their own use includes all material direct and indirect construction costs that are increased as a result of the construction. In proprietary funds and component units, interest costs incurred (if material) are capitalized during the period of construction.

Public domain ("infrastructure") general fixed assets consisting of highways, bridges, highway lands, and rights-of-way are not capitalized.

The depreciation methods and estimated lives used by proprietary funds are:

	Method	Estimated Useful Life
Buildings	Straight-line	7-50 years
Other structures and improvements	Straight-line	10-50 years
Machinery and .... equipment	Straight-line	3-15 years
	Units of output for motor vehicles	90,000 miles/ vehicle

M. Tax Refund Liabilities

Tax refund liabilities consist primarily of accrued income and sales and use tax refunds due to taxpayers. During the calendar year, the State collects employee withholdings and taxpayers' payments for income taxes. At June 30, the State estimates the amount it owes taxpayers for income tax overpayments during the preceding six months. Sales and use tax refund liabilities are also estimated at June 30. These liabilities are recorded as "Tax refunds payable".

N. Obligations Under Securities Lending

In accordance with GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, liabilities resulting from securities lending transactions are reported on the combined balance sheet.

O. Tax Judgements Payable

Tax judgement liabilities are the result of court rulings against the State.

P. Lease Obligations

Assets acquired under capital leases are generally valued at the present value of the lease payments. Capital leases of governmental funds are reported in the general long-term obligations account group and the related assets are reported in the general fixed assets account group. Capital leases for proprietary funds and college and university funds are reported in those funds, along with the related assets.

GASB Codification Section L20 and the Statement of Financial Accounting Standards No. 13, *Accounting for Leases*, issued by the Financial Accounting Standards Board (FASB), establish requirements for lease obligations. Leases meeting the standards of FASB 13 have been capitalized and are reported as capital leases payable. Other leases are accounted for as operating leases and are not recorded on the balance sheet. Operating lease payments are recorded as expenditures or expenses of the related funds when paid or incurred. Refer to Note 6 for specific disclosures on lease obligations.

All leases of the State contain appropriation clauses indicating that continuation of the lease is subject to continued funding by the Legislature. For reporting purposes, leases are fully disclosed since cancellation due to lack of appropriation is deemed unlikely.

Q. Compensated Absences

The State and its component units have adopted the accounting and reporting principles outlined in GASB Codification Section C60 regarding employee vacation leave. Since unpaid vacation leave will not be liquidated with expendable available financial resources, the State's liability for long-term accumulated unpaid vacation leave is reported in the accompanying general long-term obligations account group for all governmental funds. There is no liability in the accompanying financial statements for unpaid accumulated sick leave because the State has no obligation to pay sick leave upon employee termination or retirement.

In the proprietary funds and college and university funds, the liability for accumulated unpaid vacation leave is reported as a current liability. For the same reasons as cited for governmental funds, no liability for unpaid accumulated sick leave is recorded.

In governmental funds, the expenditure for compensated absences (vacation and sick leave) is recorded when the leave is taken. In proprietary funds the expense for vacation leave is recorded when the leave is earned. In college and university funds a year-end adjustment is recorded to reflect the current year's vacation leave expense. The expense for sick leave is recorded when the leave is taken in both proprietary and college and university funds.

The State's policy on compensated absences is generally adhered to by its agencies, departments, and most of its component units. Full-time permanent, probationary and trainee employees earn vacation leave ranging from 0.98 to 2.15 days per month, depending upon years of service. Part-time employees earn the same range of leave on a pro-rata amount based on the number of hours a week they work. There is no requirement that vacation leave be taken, but the maximum permissible accumulation is 30 days. Any vacation accumulated beyond 30 days is converted to sick leave at year end. At termination, employees are paid for any accumulated vacation leave. Full-time permanent, probationary and trainee employees earn sick leave at the rate of one day per month with an unlimited accumulation. Part-time employees earn a percentage of the total of 8 hours per month based on the number of hours a week they work. Employees are not paid for accumulated sick leave upon termination; however, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

R. Long-Term Liabilities

Long-term liabilities expected to be financed from governmental funds are accounted for in the general long-term obligations account group. Expenditures for principal and interest payments are recognized in the respective fund type when due. Long-term liabilities expected to be financed from the proprietary funds and the college and university funds, as well as the related interest payments, are accounted for in those funds.

Capital appreciation bonds are those bonds that are issued at stated interest rates (which may be zero) significantly below their effective interest rate, resulting in a substantial discount (deep discount). The implicit interest (*i.e.*, discount) is not paid until the bonds mature. Therefore, the net value of the bonds accrete (*i.e.*, the discount is reduced) over the life of the bonds. This deep-discount debt is reported in the general long-term obligations account group at its net or accreted value rather than at face value.

S. Sureties

Sureties include various assets, including securities from insurance companies doing business within North Carolina, that have been placed in safekeeping with the State Treasurer, as required by applicable general statutes.

T. Fund Equity

Contributed capital is recorded in all proprietary funds that have received capital grants or contributions from other sources. Fund balance reserved (in governmental and trust funds) and fund balance restricted (in college and university funds) represent that portion of fund balances (1) not available for appropriation or expenditure and/or (2) that is legally segregated by outside third parties for a specific future use. Refer to Note 15 for disclosure on reserves. Designations of unreserved fund balance represent tentative management plans that are subject to change.

U. Revenues

Taxes.

Taxes, net of estimated refunds, are recognized as revenue when they become both measurable and available to finance expenditures of the fiscal period.

Federal Grant Revenues.

Federal grants are recorded as receivables and as revenues when the related expenditures are incurred. Grants received before the revenue recognition criteria have been met are reported as deferred revenue.

V. Interfund Transactions

During the course of normal operations there are numerous transactions between and within fund types of the State and its component units, including expenditures and transfers of resources to provide services, construct assets, and service debt. The accompanying financial statements generally reflect such transactions as operating transfers, except for retirement contributions made by the State and its component units, which are accounted for as revenues in the pension trust funds and expenditures/expenses in the contributing funds. In addition, proprietary funds (primarily internal service funds) record charges for services to all other funds as operating revenue. All funds record their payments to proprietary funds as expenditures/operating expenses. The balances at year-end resulting from these transactions are interfund receivables or payables and are classified as "Due to," "Due from," "Advance to," or "Advance from" on the Combined Balance Sheet. The composition of the State and its component units' interfund receivables and payables is presented in Note 8.

W. Totals - Memorandum Only

The "Totals - Memorandum Only" columns on the general purpose financial statements are presented only to facilitate financial analysis. Data in these columns do not present financial position, results of operations, or cash flows in conformity with GAAP. Neither is the data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

NOTE 2: BUDGETARY ACCOUNTING AND REPORTING

A. Budgetary Process

The State of North Carolina operates on a biennial budget cycle with separate annual departmental certified budgets adopted by the General Assembly on the cash basis of accounting for the General Fund, the State Highway Fund, the Highway Trust Fund, certain special revenue funds, and capital projects funds. However, budgets adopted by the General Assembly based on annual State tax and non-tax revenues for the State Highway Fund and the Highway Trust Fund are combined with federal and local participation revenues and are primarily budgeted and accounted for on a multi-year project basis. Capital projects funds are budgeted on a project basis. Since these funds have multi-year project budgets, they are not included in the budgetary comparison statement.

The accompanying budgetary comparison statement discloses the annual "appropriated budget" for the General Fund and budgeted special revenue funds. Actual amounts in the statement are presented on the budgetary basis. Since the budgetary basis differs from generally accepted accounting principles (GAAP), a reconciliation between the budgetary basis and the GAAP basis is presented in Note 2 C.

The legal level of budgetary control is essentially at the object level. However, departments and institutions may make changes at their discretion within the budget of each purpose between and among objects for supplies and materials, current obligations and services, fixed charges and other expenses, and capital outlay. Also, Chapter 116, Article 1, Part 2A of the General Statutes authorized the sixteen universities within the University of North Carolina system to apply for special responsibility status, which sets the legal level of budgetary control at the institution's budget code level. A budget code is a convention used in the State's accounting system to distinguish the type of fund and the responsible department or institution. Budget codes are also used to segregate certain purposes within departments or institutions. Institutions with special responsibility status must still have certain budget revisions, primarily those associated with unanticipated revenues, approved by the Office of State Budget and Management (OSBM). Additionally, universities must maintain programs and services in accordance with the guidelines established by the Board of Governors of the consolidated University of North Carolina system. All sixteen universities have applied for and received special responsibility status.

Generally, unexpended appropriations at the end of the fiscal year lapse and are reappropriated in the next fiscal year. However, in certain circumstances the OSBM will allow a department to carry forward appropriations for specifically identified expenditures that will be paid in the next fiscal year. This is accomplished by the department writing a check to itself and recording a budgetary expenditure. The check is deposited in the next fiscal year as a budgetary receipt.

For the year ended June 30, 1999, there were 418 annually budgeted (*budgetary basis*) special revenue funds located in 46 departmental budget codes. A list of these funds and detailed appropriation and departmental budget information is available for public inspection in the separately published "Budgetary Compliance Report" prepared by the Office of the State Controller, 3512 Bush Street, Raleigh, NC 27609-7509 and through the Office of State Budget and Management, 116 West Jones Street, Raleigh, NC 27603-8005.

B. Fund Balance Restatement

The July 1, 1998 fund balance for budgeted special revenue funds has been restated. Most of the university funds were transferred to institutional budget codes. In addition, some funds which were budgeted in the prior year have been reclassified as unbudgeted funds during the fiscal year. The following table summarizes these restatements (expressed in thousands).

Fund balance as previously reported at June 30, 1998	$	258,441
Funds removed:		
University funds		(42,379)
Unbudgeted funds		(84,138)
Fund balance as restated at July 1, 1998	$	131,924

C. Reconciliation of Budget/GAAP Reporting Differences

The *General Fund and Special Revenue Funds, Combined Statement of Revenues, Expenditures and Changes in Unreserved Fund Balances - Budget and Actual (Budgetary Basis – Non-GAAP)* - Exhibit A-3, presents comparisons of the legally adopted budget (which is more fully described in section A, above) with actual data on a budgetary basis. Accounting principles applied to develop data on a budgetary basis differ significantly from those principles used to present financial statements in conformity with generally accepted accounting principles (GAAP). The following describes the major differences between budgetary financial data and GAAP financial data.

Entity differences. The State Highway Fund and the Highway Trust Fund, as discussed in section A, have multi-year budgets and therefore are not included in the budgetary statements. They are presented in the special revenue funds for GAAP purposes. Certain funds not included in the annual budgetary statements but which have the characteristics of governmental funds are presented in either the General Fund or the special revenue funds for GAAP purposes.

Basis differences. Budgetary funds are accounted for on the cash basis of accounting, while under GAAP the governmental funds use the modified accrual basis. Accrued revenues and expenditures are recognized in the GAAP financial statements.

Timing differences. A significant variance between budgetary practices and GAAP is the authorized carryforward of appropriated funds, which is described in section A.

The following table presents a reconciliation of resulting entity, basis, and timing differences in the fund balances (budgetary basis) at June 30, 1999 to the fund balances on a modified accrual basis (GAAP). Amounts are expressed in thousands.

	General Fund	*Special Revenue Funds*
Unreserved fund balance (Exh. A-3, budgetary basis), June 30, 1999	$ 296,702	$ 108,217
Reserved fund balance (budgetary basis),		
Savings	522,521	—
Repairs and renovation	164,683	—
Retirees' health premium	288,024	—
Work First	17,362	—
N.C. Railroad acquisition	61,000	—
Aquariums	30,000	—
Disproportionate share	19,552	—
Clean Water Management Trust Fund	31,054	—
Capital Improvements	7,000	—
Fund balance (budgetary basis)	$ 1,437,898	$ 108,217
~~Reconciling Adjustments:~~		
Entity Differences:		
Primary government:		
State Highway Fund	—	226,830
Highway Trust Fund	—	740,989
Other	211,686	1,408,749
Component unit	—	(7,949)
Basis Differences:		
Accrued revenues	90,670	4,971
Accrued expenditures		
Tax judgements	(399,000)	—
Other accrued expenditures	(711,430)	(9,881)
Other Adjustments:		
Federal retirees' refund account	287	—
Notes receivable	497	4,608
Inventories	48,105	5,477
Investments	51	—
Prepaid items	—	148
Timing Differences:		
Authorized carryforward of appropriated funds	465,366	—
Fund balance (Exh. A-2, GAAP basis) June 30, 1999	$1,144,130	$2,482,159

D. Budgetary Reserves

The North Carolina General Assembly has established several accounts in the General Fund as reserved fund balances for budgetary purposes. Funds that are transferred to these accounts from the unreserved credit balance of the General Fund can be used only for their intended purposes and on a budgetary basis are not available for appropriation.

Savings Reserve Account (G.S. 143-15.2 through 143-15.3B). One-fourth of any unreserved credit balance (budgetary basis) remaining in the General Fund at the end of each fiscal year will be transferred to the Savings Reserve account until the account contains funds equal to 5% of the amount appropriated the preceding year for the General Fund operating budget. The 1999 Session of the General Assembly under Session Law 1999-237 Section 6(d), suspended the transfer of funds from the unreserved credit balance to the Savings Reserve Account (G.S. 143-15.2 and G/S/ 143-15.3) for the 1998-99 fiscal year only.

Retirees' Health Premiums Reserve. This reserve account was established to receive and temporarily retain employer contributions for retirees' health insurance premiums made by all State agencies and universities and by local governments that have employees who are members of the State Health Plan. Since a significant portion of the funding for this account is from sources outside the reporting entity and legally restricted for a specific future use, it is reported as reserved fund balance for GAAP purposes.

Repairs and Renovations Reserve Account (G.S. 143-15.2 through 143-15.3B). This reserve account provides for a portion of the State's continuing capital needs. The reserve balance is based on 3% of the estimated replacement value of all State buildings supported from the General Fund. The funds in this account shall be used only for the repair and renovation of State facilities and related infrastructure that are supported from the General Fund.

Clean Water Management Trust Fund (G.S. 143-15.2 through 143-15.3B). This reserve account provides for the Clean Water Management Trust Fund to finance projects to clean up or prevent surface water pollution as approved by the Clean Water Management Commission. The amount reserved in the General Fund each year is defined as 6.5% of any unreserved credit balance remaining in the General Fund at the end of the fiscal year, or $30.0 million dollars, whichever is greater.

North Carolina Railroad Acquisition Reserve (1997 General Assembly, Senate Bill 352, Section 32.30). For fiscal year 1996-97, the General Assembly established the Railroad Reserve Account. In order to help promote trade, industry, and transportation within the State of North Carolina and to advance the economic interests of the State and its citizens, the General Assembly found it advantageous for the State to acquire the outstanding shares of the North Carolina Railroad Company not held by the State. On April 1, 1998 the General Fund loaned

NOTES TO THE FINANCIAL STATEMENTS

the North Carolina Railroad Company $61 million for the retirement of non-State owned common stock shares of the Railroad. The $61 million will remain in reserve until the related debt is satisfied.

Disproportionate Share Reserve Account (1997 General Assembly, Senate Bill 352, Section 11). Disproportionate share payments are Medicaid payments made to hospitals which serve a disproportionate share of indigent patients. This account was established to reserve for future appropriation any excess collection of disproportionate share revenues above those budgeted as departmental receipts or non-tax revenues.

Work First (G.S. 143-15.3C). For the fiscal year 1997-98, the General Assembly established the Work First Reserve Fund. At the end of each fiscal year, the State Controller shall reserve State funds in an amount equalling one-fourth of any Work First Program funds from General Fund appropriations remaining unexpended at the end of the fiscal year, up to a maximum balance in the account of $50 million. The General Assembly may appropriate additional funds into this reserve.

Reserve for Aquarium Construction (S.L. 1998-212 Section 29.17). For the fiscal year 1998-99, the General Assembly authorized the Office of State Budget and Management to identify unexpended General Fund appropriations from lapsed salaries to support the capital improvement project for Aquarium Construction.

Reserve for Capital Improvements (S.L. 1998-212 1999-456 Section 54). The 1999 Session of the General Assembly authorized the Director of the Office of State Budget to identify funds from any source to match federal funds for the detoxification of the Warren County polychlorinated biphenyl (PCB) landfill.

The following schedule summarizes current year changes in the budgetary reserve accounts. Amounts are expressed in thousands.

		Increases		(Decreases)			
General Fund Reserved Fund Balance	Balance June 30, 1998	Transfers from General Fund Unreserved Fund Balance	Unbudgeted Revenues	Transfers to General Fund Unreserved Fund Balance	Transfers to Non-General Fund Budgetary Funds	Unbudgeted Expenditures	Balance June 30, 1999
Savings	$ 522,521	$ —	$ —	$ —	$ —	$ —	$ 522,521
Retirees' health premium	231,682	—	184,482	—	—	(128,140)	288,024
Repairs and renovations	174,190	150,000	1,064	(145,000)	(15,571)	—	164,683
NC Railroad acquisition	61,000	—	—	—	—	—	61,000
Clean water management	47,398	31,054	—	(47,398)	—	—	31,054
DPI allocation	55,028	—	—	—	(55,028)	—	—
Disproportionate share	35,447	—	19,552	(35,447)	—	—	19,552
Aquariums	—	30,000	—	—	—	—	30,000
Work First	19,541	—	321	—	—	(2,500)	17,362
Capital Improvements	—	7,000	—	—	—	—	7,000
Total	$ 1,146,807	$ 218,054	$ 205,419	$ (227,845)	$ (70,599)	$ (130,640)	$ 1,141,196

NOTE 3: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Retained Earnings / Fund Balance Deficit

Primary Government

At June 30, 1999, the special revenue fund Educational Materials, School Buses Fund reported unreserved/undesignated fund balance deficit of $21.812 million.

At June 30, 1999, the following enterprise funds reported retained earnings deficits: Agricultural Farmers Market, $3.696 million; Indian Cultural Tourist Center, $99 thousand; and Workers' Compensation, $6.366 million.

At June 30, 1999, the following internal service funds reported retained earnings deficits: Applications Development Services, $163 thousand; Cherry Hospital Auxiliary Services, $1.814 million; John Umstead Hospital Auxiliary Services, $3.288 million; and the Disability Income Plan of N.C., $29.318 million.

Component Units

At June 30, 1999, the North Carolina Low Level Radioactive Waste Management Authority (component unit proprietary fund) had a $33.384 million retained earnings deficit. The financial statements of the Authority have been prepared following the accounting principles that apply to developmental stage enterprises. The retained earnings deficit reflects losses sustained in the developmental stage. The North Carolina Low Level Radioactive Waste Management Authority was created in 1987 to locate, build, operate and close a repository in North Carolina. In July 1999, the General Assembly ratified Senate Bill 247 which withdraws North Carolina from the Southeast Compact after the State's unsuccessful attempts to locate a suitable geographic site for toxic waste storage. Each state within the Southeast Compact was to assume responsibility, on a twenty year rotating basis, as the Southeast's low-level radioactive waste repository. Additionally, Senate Bill 247 established that the sole function of the Authority is to finalize all business relating to closure and restoration of its proposed waste site on or before June 30, 2000. As of July 1, 2000, the Authority will officially cease to exist. Since the Authority currently has no revenue sources, the advance to the Authority is considered to be uncollectible.

At June 30, 1999, the North Carolina Railroad Company (component unit proprietary fund) had a $51.709 million retained earnings deficit.

NOTE 4: DEPOSITS AND INVESTMENTS

A. Deposits and Investments with State Treasurer

Unless specifically exempt, every agency of the State and certain component units are required by General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. Certain local governmental units that are not part of the reporting entity are also allowed to deposit money with the State Treasurer. Expenditures for the primary government and certain component units are made by warrants issued by the agencies and drawn on the State Treasurer. The State Treasurer processes these warrants each day when presented by the Federal Reserve Bank or the local clearing banks. General Statute 147-69.1 authorizes the State Treasurer to invest all deposits in obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; shares, deposits, savings certificates, and certificates of deposit of specified institutions; prime quality commercial paper; specified bills of exchange or time drafts; asset-backed securities; and corporate bonds and notes with specified ratings.

General Statute 147-69.2 authorizes the State Treasurer to invest the deposits of certain special funds, including the pension trust funds, the State Health Plan, the Disability Income Plan of N.C., the Escheats Fund, the Public School Insurance Fund, the State Education Assistance Authority, and trust funds of the University of North Carolina system, in the investments authorized in General Statute 147-69.1; general obligations of other states; general obligations of North Carolina local governments; certain venture capital limited partnerships; and the obligations or securities of the North Carolina Enterprise Corporation. The deposits of the pension trust funds may be invested in all of the above plus certain insurance contracts; individual and group trusts; certain real estate investment funds; and certain stocks and mutual funds.

<u>External Investment Pool</u>

To ensure that these and other legal and regulatory limitations are met, all cash deposited with the State Treasurer, except for bond proceeds, is maintained in the Investment Pool. This pool, a governmental external investment pool, consists of the following individual investment portfolios:

Short-term Investment – This portfolio may hold any of the investments authorized by General Statute 147-69.1. The Short-term Investment portfolio is the primary cash management account for the State and is managed in such a manner as to be readily convertible into cash. The primary participants of this portfolio are the General Fund and the Highway Funds. Other participants include the remaining portfolios listed below and various boards, commissions, community colleges, and school administrative units that make voluntary deposits with the State Treasurer.

Long-term Investment – This portfolio may hold the fixed-income investments authorized by General Statutes 147-69.1 and 147-69.2. Since the deposits in this fund are typically not needed for day-to-day operations, the investment vehicles used generally have a longer term and higher return than those held in the Short-term Investment portfolio. The primary participants of the portfolio are the Pension Trust Funds and various special trust funds.

Equity Investment – This portfolio holds equity-based trusts. The State’s pension trust funds are the sole participants in the portfolio.

Real Estate Investment – This portfolio holds investments in real estate-based trust funds and group annuity contracts. The State's pension trust funds are the sole participants in the portfolio.

Venture Capital Investment – This portfolio holds investments in venture capital limited partnerships, the long-term investment portfolio and equities received in the form of distributions from its primary investments. The State’s pension trust funds are the sole participants in the portfolio.

All of the above investment portfolios operate like individual investment pools, except that an investment portfolio may hold shares in other investment portfolios at the discretion of the State Treasurer and subject to the legal limitations discussed above. To this extent, the deposits are commingled; and therefore, the State Treasurer considers all investment portfolios to be part of a single pool, the Investment Pool. The Investment Pool contains deposits from funds and component units of the reporting entity (internal portion) as well as deposits from certain legally separate organizations outside the reporting entity (external portion). This pool is not registered with the SEC and is not subject to any formal oversight other than that of the legislative body.

At year end, the financial statements for the Investment Pool maintained by the State Treasurer were as follows (dollars in thousands):

NOTES TO THE FINANCIAL STATEMENTS

Statement of Net Assets
June 30, 1999

Assets:	
Cash in bank	$ 99,289
Accrued investment income	505,441
Investments	71,371,255
Total assets	71,975,985
Liabilities:	
Distributions payable	43,007
Obligations under securities lending	7,751,232
Total liabilities	7,794,239
Net Assets:	
Internal:	
Primary government	61,762,471
Component units	1,673,270
External	746,005
Total net assets	$ 64,181,746

Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 1999

Increase in net assets from operations:	
Revenues:	
Investment income	$ 6,307,562
Expenses:	
Securities lending expenses	387,073
Investment management	43,879
Total expenses	430,952
Net increase in net assets resulting from operations	5,876,610
Distributions to participants:	
Distributions paid and payable	(3,458,068)
Share transactions:	
Reinvestment of distributions	3,456,796
Net share purchases	(550,104)
Total increase in net assets	5,325,234
Net assets:	
Beginning of year	58,856,512
End of year	$ 64,181,746

The external portion of the Investment Pool is presented in the State's financial statements as an investment trust fund. Each fund and component unit's share of the internal equity in the Investment Pool is reported in the State's financial statements as an asset of those funds or component units. Equity in the Short-term Investment portfolio is reported as cash and cash equivalents while equity in the Long-term Investment, Equity Investment, Real Estate Investment, and Venture Capital Investment portfolios is reported as investments. The internal equity of the investment pool differs from the amount of assets reported by the funds and component units due to the typical banker/customer outstanding and in-transit items. Additionally, each fund or component unit's share of the assets and liabilities arising from securities lending transactions are reported in the funds and component units.

Investments in nonparticipating contracts, such as nonnegotiable certificates of deposit, are reported at cost. Other investments held in the Short-term Investment portfolio are reported at amortized cost, which approximates fair value. All other investments are reported at fair value. Fair values are determined monthly for the Long-term Investment and Equity Investment portfolios and quarterly for the Real Estate Investment and Venture Capital portfolios. The fair value of fixed income securities is based on future principal and interest payments discounted using current yields for similar instruments. Investments in real estate funds, venture capital limited partnerships, and equity investment funds are valued using market prices provided by the investment managers. Participants' shares sold and redeemed are determined in the same manner as is used to report investments, and the State Treasurer does not provide or obtain legally binding guarantees to support share values.

Net investment income earned by the Investment Pool is generally distributed on a pro rata basis. However, in accordance with legal requirements, the general fund receives all investment income earned by funds created for purposes of meeting appropriations. For the fiscal year ended June 30, 1999, $85,018,634 of investment income associated with other funds was distributed to the general fund.

Bond Proceeds Investment Accounts

The State Treasurer has established separate investment accounts for each State bond issue to comply with IRS regulations on bond arbitrage. A private investment company under contract with the State Treasurer manages these separate accounts. The investments are valued at amortized cost, which approximates fair value. In the financial statements, each fund's equity in these accounts is reported as cash and cash equivalents.

Demand and Time Deposits

Agency deposits to the investment pool may be made in any bank, savings and loan association or trust company in the State approved by the State Treasurer. Depositories are required, in accordance with the rules in the North Carolina Administrative Code (Chapter 20 NCAC 7), to collateralize all balances of the State Treasurer which are not insured. Basically, these rules require that the bank maintain, as collateral in an escrow account established by the State Treasurer with a third-party bank, securities of a type enumerated in the rules, in an amount whose market value is not less than the amount of the time deposits and the average balance of demand deposits for the preceding quarter less the allowable deposit insurance on the deposits. Generally, rules require the securities to be governmental in origin (e.g., U.S. Treasury and U.S. agency obligations, or state and local government obligations) or the highest grade commercial paper and bankers' acceptances. Financial institutions generally may elect to collateralize deposits separately (dedicated method) or to include the deposits of North Carolina local government units in the same collateral pool with the State and certain component units (pooling method). Financial institutions report quarterly on bank balances and amounts deposited in escrow as collateralization of deposits. The State Treasurer maintains no records of financial institution balances of local governments collateralized in the pool with State Treasurer deposits. Since the amounts of local government deposits in the pooling method banks are not known, the risk of being under-collateralized at any given time is increased. Therefore, the institution's financial condition may cause the State Treasurer to require a particular institution to utilize the dedicated method exclusively for the protection of each public depositor.

At June 30, 1999, the deposits maintained by the State Treasurer consisted of (dollars in thousands):

	Carrying Value	*Bank Balance*
Demand............................	$ 99,289	$ 117,258
Time.................................	157,446	157,446
Total Deposits..................	$ 256,735	$ 274,704

At year end, 96 percent of the balances in financial institutions were deposited under the pooling method. Because the financial institutions complied with the collateralization policies and procedures by utilizing either the dedicated method or the pooling method described above, the State Treasurer considers all of its deposits to be either insured or covered by collateral held by the escrow agent.

Investments

Investments held by the Investment Pool and the bond proceeds investment accounts are categorized into three categories of credit risk to give an indication of the level of credit risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the owner or its agent in the owner's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the financial institution's trust department or agent in the owner's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by a financial institution's trust department or agent, but not in the owner's name. At year end, the balances of the Investment Pool maintained by the State Treasurer were as follows (dollars in thousands):

Investment Pool	*Category* 1	*Category* 3	*Carrying Amount*
Investments Categorized:			
U.S. government and agency securities:			
Not on loan..	$ 14,209,290	$ 178,522	$ 14,387,812
On loan for securities collateral..............	890,499	—	890,499
Corporate bonds and notes:			
Not on loan..	8,985,628	4,502,814	13,488,442
On loan for securities collateral..............	6,379	—	6,379
Repurchase agreements..........................	125,000	2,717,015	2,842,015
Commercial paper..................................	—	352,881	352,881
International bonds..................................	521,103	—	521,103
Domestic equities....................................	12,663	—	12,663
Total Investments Categorized...........	$ 24,750,562	$ 7,751,232	32,501,794

Investments Not Categorized:		
	Certificates of deposit................	157,446
	Equity-based trusts....................	30,323,126
	Venture capital investments.......	37,157
	Real estate trust funds..............	712,200
	Investments held by broker/dealers under securities loans with cash collateral:	
	U.S. government and agency securities.............	7,451,759
	Corporate bonds and notes..	187,773
	Total Investment Pool.............	$ 71,371,255

The above certificates of deposit are a component of the deposit totals reported in the State Treasurer's demand and time deposit section of this note. At year end, the major investment classifications of the Investment Pool had the following attributes (dollars in thousands):

~~*Investment Classification*~~	*Carrying Amount*	*Principal Amount*	*Range of Interest Rates*	*Range of Maturities*
U.S. government and agency securities:				
U.S. Treasury notes and bonds.............	$ 15,865,626	$ 14,990,264	4.25 to 9.125%	15 days to 3 years
GNMA securities....................................	4,705,173	4,791,831	6.0 to 9.0%	18 years to 30 years
U.S. agency notes and bonds................	2,159,271	2,227,500	zero to 6.7%	19 days to 29 years
Corporate bonds and notes.......................	13,682,594	13,863,726	4.875 to 14.5%	1 year to 36 years
Repurchase agreements...........................	2,842,015	2,840,991	4.78 to 6.1%	1 to 13 days
Equity-based trusts....................................	30,323,126	Not applicable	Not applicable	Not applicable

NOTES TO THE FINANCIAL STATEMENTS

The equity-based trusts are investments in trust funds managed by third party money managers. The trust funds invest in common stocks and other equity-type securities. For these investments, the State Treasurer does not own individual securities but rather has a percentage ownership in the trust.

Included in the "U.S. government and agency securities" investment category are mortgage-backed securities issued by an agency of the United States government, the Government National Mortgage Association (GNMA). The State Treasurer invests in these securities to maximize yield while maintaining a high degree of safety. The securities are based on cash flows from payments on underlying mortgages. Although these investments are not derivatives, the investment values are sensitive to mortgage prepayments that tend to occur during periods of declining interest rates.

Derivatives are not widely used by the State Treasurer's Investment Pool. However, certain portfolios within the Investment Pool utilize third-party professional managers that may invest in collateralized mortgage obligations, financial futures, forwards, options, swaps and mutual funds that may also invest in such derivatives. The State Treasurer does not have any direct involvement over these transactions nor are they material.

At year end, the balances of the bond proceeds investments were as follows (dollars in thousands):

Bond Proceeds	Category 1	Carrying Amount
Investments Categorized:		
U.S. government and agency securities....	$ 75,441	$ 75,441
Repurchase agreements..........................	506,121	506,121
Commercial paper...................................	195,255	195,255
Total Investments..............................	$ 776,817	$ 776,817

Securities Lending

Based on the authority provided in G.S. 147-69.3(e), the State Treasurer lends securities from its Investment Pool to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer's securities custodian manages the securities lending program. During the year the custodian lent U.S. government securities, corporate bonds and notes for collateral. The custodian is permitted to receive cash, U.S. government securities, or irrevocable letters of credit as collateral for the securities lent. The collateral is initially pledged at 102 percent of the market value of the securities lent, and additional collateral is required if its value falls to less than 100 percent of the market value of the securities lent. There are no restrictions on the amount of loans that can be made. Substantially all security loans can be terminated on demand by either the State Treasurer or the borrower. Securities lent at year-end for cash collateral are presented as unclassified in the preceding schedule of custodial credit risk; securities lent for securities collateral are classified according to the category for the collateral. The State Treasurer cannot pledge or sell the collateral securities received unless the borrower defaults.

The cash collateral received is invested by the custodian agent and held in a separate account in the name of the State Treasurer. The average maturities of the cash collateral investments do not differ materially from the average maturities of the securities lent. While cash can be invested in securities ranging from overnight to two years, the custodian agent is not permitted to make investments where the weighted average maturity of all investments exceeds 90 days. At June 30, 1999, the weighted average maturity of unmatched investments was approximately two weeks.

At year-end, the State Treasurer had no credit risk exposure to borrowers because the amounts the Treasurer owed the borrowers exceeded the amounts the borrowers owed the State. The securities custodian is contractually obligated to indemnify the Treasurer for certain conditions, the two most important are default on the part of the borrowers and failure to maintain the daily mark-to-market on the loans.

B. Deposits Outside the State Treasurer

In addition to the pooled deposits maintained by the State Treasurer, other deposits are maintained outside the State Treasurer by the primary government and by certain component units. As a general rule, these deposits are not covered by the rules in Chapter 20 NCAC 7 requiring collateralization of uninsured deposits.

At June 30, 1999, the deposits maintained outside the State Treasurer by the primary government consisted of (dollars in thousands):

	Carrying Value	Bank Balance
Demand............................	$ 16,318	$ 21,787
Time.................................	760,827	773,584
Total Deposits..................	$ 777,145	$ 795,371

Of these bank balances, $359.548 million was covered by federal depository insurance, $396.783 million by collateral held by the escrow agent in the depositor's name, and $39.040 million was uninsured and uncollateralized. In addition, the North Carolina Employment Security Commission had $1.284 billion on deposit with the U.S. Treasurer at June 30, 1999.

NOTES TO THE FINANCIAL STATEMENTS

At June 30, 1999, the deposits maintained by the component units consisted of (dollars in thousands):

	Carrying Value	Bank Balance
Demand	$ 38,771	$ 17,128
Time	89,982	102,013
Total Deposits	$ 128,753	$ 119,141

Of these bank balances, $16.666 million was covered by federal depository insurance, $17.971 million by collateral held by the escrow agent in the depositor's name, $29.761 million was covered under the State Treasurer's collateral pool, $6.607 million was covered by collateral held in the pledging bank's trust department in the depositor's name and $48.136 million was uninsured and uncollateralized.

C. Investments Outside the State Treasurer

Investments in participating investment contracts, external investment pools, open-end mutual funds, debt securities, equity securities, and all investments of the Deferred Compensation Plan are reported at fair value. Investments in certificates of deposit, investment agreements, bank investment contracts, real estate, real estate investment trusts, and limited partnerships are reported at cost. Detailed disclosures about investments held outside the State Treasurer are presented below.

Primary Government

All organizations within the primary government are required to follow certain investment guidelines as outlined by the General Statutes. Of these organizations, the various clerks of superior court, the N.C. Deferred Compensation Plan (457), and the 401(k) Supplemental Retirement Income Plan comprise 98% of the total investments maintained by primary government at June 30, 1999. The investments by these funds adhere to the following General Statutes guidelines.

General Statute 7A-112(a) authorizes the Clerk of the Superior Court to invest in the following: (a) Obligations of or fully guaranteed by the United States as to both principal and interest; (b) Obligations of the State of North Carolina; (c) General obligations of cities, counties, and special districts in North Carolina; (d) Shares of or deposits in specified savings and loan associations; (e) Savings certificates issued by specified savings and loan associations; (f) Certificates of deposit issued by specified banks.

General Statute 143B-426.25(j) allows the Deferred Compensation Plan Board to acquire investment vehicles from any company authorized to conduct such business in this State or may establish, alter, amend and modify, to the extent it deems necessary or desirable, a trust for the purpose of facilitating the administration, investment and maintenance of assets acquired by the investment of deferred funds. Any assets of such investment vehicles or trusts shall remain solely the property and rights of the State subject only to the claims of the State's general creditors.

General Statute 135-90 places no specific investment restrictions on the 401(k) Supplemental Retirement Income Plan. However, in the absence of specific legislation, the form of governance over the investments would be the prudent-person or prudent-expert rule. These rules are broad statements of intent, generally requiring investment selection and management to be made with prudent, discreet, and intelligent judgment and care.

At year end the investment balances maintained outside the State Treasurer for the primary government were as follows (dollars in thousands):

	Category 1	Category 2	Category 3	Carrying Amount
Investments Categorized:				
U.S. Government securities	$ 13,734	$ 611	$ 597	$ 14,942
State and municipal securities	686	—	—	686
Corporate bonds	—	—	32	32
Corporate common stock	51	—	603	654
Total Investments Categorized	$ 14,471	$ 611	$ 1,232	16,314
Investments Not Categorized:				
Certificates of deposits				77,323
Bank investment contracts				322,715
Money market funds				2,120
Mutual funds				1,614,284
Annuity contracts				230,451
Other investments				15,778
Total Investments				$ 2,278,985

NOTES TO THE FINANCIAL STATEMENTS

The above certificates of deposit and bank investment contracts are a component of the deposit totals reported in the Deposits Outside the State Treasurer section of this note.

Component Units

The component units of the State (except for the North Carolina Railroad) are required to follow certain investment guidelines as outlined by the General Statutes. The component units include the University of North Carolina system, the community colleges and proprietary component units, such as the North Carolina Biotechnology Center, the North Carolina State Ports Authority, the Rural Economic Development Center, and the North Carolina Housing Finance Agency. The investments by these units comprise 98% of the total investments maintained by the component units at June 30, 1999. The investments by the component units adhere to the following General Statutes guidelines.

General Statute 115D-58.6 authorizes the community colleges to invest in the following: (a) Obligations of or fully guaranteed by the United States; (b) Obligations of the State of North Carolina; (c) Bonds and notes of any North Carolina local government or public authority; (d) Obligations of certain non-guaranteed federal agencies; (e) Prime quality commercial paper bearing specified ratings and bankers' acceptances; (f) The North Carolina Cash Management Trust, an SEC registered mutual fund; (g) Commingled investment pool established and administered by the State Treasurer; (h) Repurchase agreements; (i) Evidences of ownership of, or fractional undivided interests in, future interest and principal payments on either direct obligations of or fully guaranteed by the United States government, which are held by a specified bank or trust company or any state in the capacity.

General Statute 122A-11 authorizes the North Carolina Housing Finance Agency to invest in the following: (a) Shares of or deposits in banks or trust companies outside as well as in this State, provided any such moneys on deposit outside this State are collateralized to the same extent and manner as if deposited in this State; (b) Evidences of ownership of, or fractional undivided interests in, future interest and principal payments on either direct obligations of or fully guaranteed by the United States government, which are held by a specified bank or trust company or any state in the capacity of custodian; (c) Obligations which are collateralized by mortgage pass-through securities guaranteed by the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Federal National Mortgage Association; (d) Trust certificate or similar instrument evidencing an equity investment in a trust or similar arrangement, which is formed for the purpose of issuing obligations which are collateralized by mortgage pass-through or participation certificates guaranteed by the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Federal National Mortgage Association; (e) Repurchase agreements.

The General Statutes place no specific investment restrictions on the University of North Carolina system, the Rural Economic Development Center, the North Carolina Biotechnology Center, or the North Carolina State Ports Authority. However, in the absence of specific legislation, the form of governance over these investments would be the prudent-person or prudent-expert rule. These rules are broad statements of intent, generally requiring investment selection and management to be made with prudent, discreet, and intelligent judgment and care. The University of North Carolina at Chapel Hill operates an Investment Fund, which is a governmental external investment pool. The University operates the Investment Fund for charitable, nonprofit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. Separate financial statements for the Investment Fund may be obtained from the University.

At year end, investment balances maintained outside the State Treasurer for the component units were as follows (dollars in thousands):

	Category 1	Category 2	Category 3	Carrying Amount
Investments Categorized:				
U.S. Government securities......................	$ 170,647	$ 37,514	$ 18,537	$ 226,698
Collateralized mortgage obligations..........	44,388	3,026	—	47,414
State and municipal securities.................	5,853	110	—	5,963
Corporate bonds......................................	67,302	5,877	1,405	74,584
Corporate common stock..........................	240,479	106,779	16,740	363,998
Repurchase agreements...........................	217,937	1,341	2,264	221,542
Commercial paper....................................	22,276	1,000	—	23,276
International corporate bonds...................	102	—	—	102
International government bonds................	371	—	—	371
International equity securities...................	162,270	2,614	—	164,884
Total Investments Categorized.........	$ 931,625	$ 158,261	$ 38,946	1,128,832
Investments Not Categorized:	Certificates of deposits...			27,394
	Investment agreements..			13,429
	Money market funds...			139,689
	Mutual funds...			330,197
	Real estate...			39,610
	Real estate investment trust...................................			35,805
	Limited partnerships...			210,909
	Investments held by broker-dealers under reverse repurchase agreements:			
	U.S. Government securities.............................			91,020
	N.C. Cash Management Trust................................			866
	Other investments..			37,608
	Total Investments...			$ 2,055,359

The above certificates of deposit, investment agreements and bank investment contracts are a component of the deposit totals reported in the Deposits Outside the State Treasurer (component units) section of this note.

Derivatives are not widely used by the various component units investing outside the State Treasurer. Of the above balances, only the Collateralized Mortgage Obligations (CMOs) and certain investments held by limited partnerships were considered material derivative positions during the year.

NOTES TO THE FINANCIAL STATEMENTS

Collateralized Mortgage Obligations - The University of North Carolina at Chapel Hill and UNC Hospitals invest in collateralized mortgage obligations (CMOs) issued by FNMA, FHLMC and by certain trusts and private corporations. In a CMO, cash flows from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple classes with different priority claims and payment streams (commonly referred to as tranches.) A holder of the security thus chooses the class of security that best meets risk and return objectives. CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates, and various liquidity factors related to their specific markets. The University and UNC Hospitals invest in these securities to increase the yield and return on their investment portfolios given the available alternative investment opportunities.

Limited Partnerships - The limited partnership positions are held by the University of North Carolina at Chapel Hill. The University uses various external money managers to identify specific investment funds and limited partnerships that meet asset allocation and investment management objectives. The University invests in these funds and partnerships to increase the yield and return on its investment portfolio given the available alternative investment opportunities and to diversify its asset holdings. These investments generally include equity and bond funds. Certain of these investments expose the University to significant amounts of market risk by trading or holding derivative securities and by leveraging the securities in the fund. The book value of these investments reflects their cost. The University limits the amount of funds managed by any single asset manager and also limits the amount of funds to be invested in particular security classes.

Reverse Repurchase Agreements - The University of North Carolina at Chapel Hill enters into fixed coupon reverse repurchase agreements, that is, the sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing dealers a margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the University or provide securities or cash of equal value, the University would suffer an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. This credit exposure at year-end was $5.5 million. All sales under reverse repurchase agreements are for fixed terms. The University's policy for investing the proceeds of reverse repurchase agreements is that the term to maturity of the investment be the same as the term of the reverse repurchase agreement. Such matching existed at year-end.

NOTE 5: FIXED ASSETS

Primary Government:

A summary of changes in general fixed assets for the year ended June 30, 1999 is presented below (dollars in thousands).

	Balance July 1, 1998	Prior Year Adjustments	Transfers Between Assets	Transfers Between Funds	Additions	Deletions	Balance June 30, 1999
Land	$ 258,419	$ 24,474	$ 85	$ (9)	$ 28,330	$ 10,223	$ 301,076
Buildings	1,386,502	382	38,523	104,361	2,193	2,557	1,529,404
Other structures and improvements	141,042	493	2,137	1,046	3,302	772	147,248
Machinery and equipment	968,045	489	268	217	119,539	47,138	1,041,420
Art, literature and artifacts	38,908	1,084	—	—	3,481	62	43,411
Construction in progress	385,633	(6,051)	(41,013)	(115,647)	97,899	317	320,504
Total — General Fixed Assets	$ 3,178,549	$ 20,871	$ —	$ (10,032)	$ 254,744	$ 61,069	$ 3,383,063

A summary of proprietary funds' fixed assets by classification for the primary government, at June 30, 1999, is presented below (dollars in thousands).

	Enterprise	Internal Service
Land	$ 2,855	$ 3,608
Buildings	25,658	38,029
Other structures and improvements	7,068	12,316
Machinery and equipment	2,674	275,469
Construction in progress	774	10,538
	39,029	339,960
Less: Accumulated depreciation	(16,966)	(158,451)
Total Fixed Assets	$ 22,063	$ 181,509

Component Units:

A summary of fixed assets by classification for the component units, at June 30, 1999, is presented below (dollars in thousands).

	Proprietary Funds						
	N.C. State Ports Authority	N.C. Global TransPark Authority	MCNC	North Carolina Railroad	N.C. Biotechnology Center	Other Component Units	Total
Land	$ 12,807	$ 6,923	$ —	$ —	$ —	$ 525	$ 20,255
Buildings	110,816	6,689	32,889	339	7,271	1,997	160,001
Other structures and improvements	39,741	7,815	—	7,848	—	172	55,576
Machinery and equipment	51,716	1,635	14,572	—	1,614	4,778	74,315
Construction in progress	1,782	9,136	—	—	—	154	11,072
	216,862	32,198	47,461	8,187	8,885	7,626	321,219
Less:							
Accumulated depreciation	(94,799)	(5,835)	(37,496)	(326)	(3,197)	(2,838)	(144,491)
Total Fixed Assets	$ 122,063	$ 26,363	$ 9,965	$ 7,861	$ 5,688	$ 4,788	$ 176,728

	College and University Funds		
	University	Community Colleges	Total
Land	$ 65,695	$ 80,701	$ 146,396
Buildings	2,868,093	765,741	3,633,834
Other structures and improvements	259,644	39,341	298,985
Machinery and equipment	690,163	119,421	809,584
Art, literature and artifacts	649,583	66,842	716,425
Construction in progress	487,745	154,717	642,462
Total Fixed Assets	$ 5,020,923	$ 1,226,763	$ 6,247,686

NOTE 6: LEASE OBLIGATIONS—OPERATING AND CAPITAL

The State and its component units have entered into various operating and capital leases for office space and for office, communications, computer and other equipment. Any operating leases with scheduled rent increases are considered immaterial to the future minimum lease payments and current rental expenditures. Operating lease payments are recorded as expenditures or expenses of the related funds when paid or incurred. For the year ended June 30, 1999, total operating lease expenditures were $38,064,257 for Primary Government, $16,922,012 for Universities, $3,527,367 for Community Colleges, and $610,862 for other component units. Future minimum lease commitments for noncancelable operating leases and capital leases as of June 30, 1999 are (dollars in thousands):

	Operating Leases		**Capital Leases**				
			Primary Government	*Component Units*			
Fiscal Year	*Primary Government*	*Component Units*	General Long-Term Obligations	University Funds	Community Colleges Funds	Total Colleges and University Funds	*Proprietary*
2000	$ 33,428	$ 13,634	$ 442	$ 151	$ 230	$ 381	$ 1,174
2001	25,298	10,398	374	144	153	297	1,563
2002	18,302	6,599	191	123	8	131	3
2003	12,391	4,467	—	117	—	117	—
2004	8,950	2,331	—	117	—	117	—
Thereafter	28,842	15,440	—	195	—	195	—
Total Future Minimum Lease Payments	$ 127,211	$ 52,869	1,007	847	391	1,238	2,740
Less Amounts Representing Interest			103	200	41	241	516
Present Value of Future Minimum Lease Payments			$ 904	$ 647	$ 350	$ 997	$ 2,224

Falls Lake Operating Lease. The State has leased from the federal government approximately 40,000 acres of land and water areas at Falls Lake, located in Wake and Durham counties. The agreement allows the State to operate the areas for recreational purposes, and in return the State agreed to pay for one half of the development costs. Payments, which have not yet begun, are to take place over 50 years with an option to prepay. Current cost estimates indicate that the State has a total obligation of $57.8 million, including $31.4 million in interest and $26.4 million in principal. Annual payments are estimated to be $1.156 million beginning in fiscal year 1999-2000. Since the costs and payment period are yet to be finalized, this commitment has not been included in the above table.

NOTE 7: LONG-TERM OBLIGATIONS

A. Changes in Long-Term Liabilities

During the year ended June 30, 1999, the following changes occurred in liabilities reported in the general long-term obligations account group (dollars in thousands):

	Rates	Balance June 30, 1998	Accretion	Increases	Decreases	Balance June 30, 1999
General Obligation Bonds :						
Public School Facility, Series C, 6-1-76	4.0-6.0	$ 2,000	$ —	$ —	$ 2,000	$ —
Clean Water, Series C, 6-1-76	4.0-6.0	1,000	—	—	1,000	—
Public Improvement, 1979, 11-1-79	5.5-7.5	5,000	—	—	5,000	—
Capital Improvement, Series 1989, 5-1-89	6.5-6.9	14,349	994	—	1,910	13,433
Capital Improvement, Series A, 3-1-91	5.75-6.0	33,100	—	—	8,300	24,800
Capital Improvement, Series 1991, 10-1-91	5.3-5.6	24,900	—	—	6,200	18,700
Prison and Youth Services Facilities, Series A, 3-1-92	5.9-6.2	35,200	—	—	8,800	26,400
Prison and Youth Services Facilities, Series B, 10-1-93	2.5-4.5	76,500	—	—	3,600	72,900
Public Improvement Refunding, Series 1993, 10-1-93	2.4-5.5	39,585	—	—	17,665	21,920
Clean Water Refunding, Series 1993, 10-1-93	3.0-5.0	10,625	—	—	4,130	6,495
Prison & Youth Services Facilities Refunding, Series C, 10-15-93	4.2-4.8	64,685	—	—	590	64,095
Capital Improvement, Series 1994A, 2-1-94	4.6-4.75	372,000	—	—	7,500	364,500
Clean Water, Series 1994A, 10-1-94	5.7-5.8	36,000	—	—	26,000	10,000
Clean Water, Series 1994B, 11-1-94	4.7-5.0	8,000	—	—	4,000	4,000
Clean Water, Series 1995A, 6-1-95	5.0-5.25	57,000	—	—	3,000	54,000
Clean Water, Series 1995B, 7/1/95	4.25-4.3	10,000	—	—	5,000	5,000
Capital Improvement, Series 1997, 1-1-97	4.8-5.1	192,000	—	—	3,000	189,000
Public School Building, Series 1997A, 3-1-97	5.1-5.2	442,000	—	—	8,000	434,000
Public School Building, Series 1998A, 4-1-98	4.75-5.0	450,000	—	—	16,000	434,000
Highway, Series 1997A, 11-1-97	4.5-5.0	250,000	—	—	16,675	233,325
Public School Building, Series 1999, 4-1-99	4.5-5.0	—	—	450,000	—	450,000
Clean Water Refunding, Series 1999, 4-1-99	2.9-5.0	—	—	25,905	500	25,405
Total Bonds Payable		2,123,944	994	475,905	148,870	2,451,973
Other Long-Term Obligations :						
Tax judgements payable		732,000	—	107,000	399,000	440,000
Notes payable	5.7-5.77	4,166	—	1,123	2,019	3,270
Deferred death benefit payable		100	—	45	—	145
Obligations for workers' compensation		7,301	—	88	602	6,787
Capital leases payable		190	—	841	127	904
Accrued vacation leave		191,392	—	10,513	8,927	192,978
Total General Long-Term Obligations		$ 3,059,093	$ 994	$ 595,515	$ 559,545	$ 3,096,057

B. Tax Judgements Payable

On May 25, 1999, the North Carolina Superior Court entered judgement in *Smith* against the State in the amount paid by non-protesting taxpayers for tax years 1991-1994. In a closely related class action tax refund case, *Shaver* v. *State of North Carolina*, filed July 16, 1998, non-protesting taxpayers sought refunds, totaling approximately $100 million, for tax year 1990. On July 8, 1999, class counsel in *Smith* and *Shaver* entered into a settlement agreement with the State, subject to the General Assembly's approval, providing for the payment of the *Smith* and *Shaver* claims for a total of $440 million to be paid in two installments. The settlement agreement provided for an initial payment of $200 million to be paid on October 1, 1999, and a final payment of $240 million on July 10, 2000. The liability of $440 million is reported in the General Long-term Obligations Account Group.

NOTES TO THE FINANCIAL STATEMENTS

C. Bonds and Notes Payable

Bonds and notes payable at June 30, 1999 were (dollars in thousands):

	Interest Rates	Final Maturity	Total
Primary Government:			
General long-term obligations:			
Bonds payable....................	2.4 - 6.9	4/1/18	$ 2,451,973
General long-term obligations:			
Notes payable.....................	5.7-5.77	7/1/13	3,270
Component Units:			
University Funds:			
Bonds payable..................	2.88 - 9.25	2/15/29	897,654
Other Component Units:			
Housing Finance:			
Bonds payable................	3.6 - 8.25	1/1/30	1,001,137
Other:			
Bonds payable................	3.45 - 6.35	7/1/28	534,347
College and University Funds:			
Notes payable...................	0.00-7.4	5/1/22	20,163
Other Component Units:			
Notes payable...................	1.0 - 8.88	4/20/08	28,314

The full faith, credit, and taxing power of the State has been pledged only for the payment of the principal of and the interest on the general obligation serial bonds and capital appreciation bonds. Other long-term debts of the State and its component units are payable solely from certain resources of the funds to which they relate.

D. Bonds Authorized but Unissued

In November 1996, the voters of North Carolina approved bonds in the amount of $1.8 billion for school construction and $950 million for highway construction. On November 1, 1997, $250 million of Highway Bonds, Series 1997A, with a settlement date of May 1, 2013, were sold. On April 1, 1998, $450 million of Public School Building Bonds, with a settlement date of April 1, 2016, were sold and on April 1, 1999, $450 million of Public School Building Bonds, with a settlement date of April 1, 2018, were sold. In November 1998, North Carolina voters approved $800 million of new debt to finance grants and loans to local government units for water supply systems, wastewater collection systems, wastewater treatment works, and water conservation and water reuse projects. In addition, $200 million of new debt was approved to finance grants, loans, or other financing to public or private entities for construction of natural gas facilities. The amount of authorized but unissued bonds was $2.15 billion as of June 30, 1999.

The limitations on the increase of State debt are contained in the State Constitution, Article 5, Section 3. This section restricts the General Assembly from contracting debts secured by a pledge of the faith and credit of the State, unless approved by a majority of the qualified voters of the State except for:

1. To fund or refund a valid existing debt;
2. To supply an unforeseen deficiency in the revenue;
3. To borrow in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50 percent of such taxes;
4. To suppress riots or insurrections, or to repel invasions;
5. To meet emergencies immediately threatening the public health or safety, as conclusively determined in writing by the Governor;
6. For any other lawful purposes, to the extent of two-thirds of the amount by which the State's outstanding indebtedness shall have been reduced during the next preceding biennium.

E. Capital Appreciation Bonds

General Obligation Bonds

Capital Improvement Bonds, Series 1989, 5-1-89, 5-24-89, include capital appreciation bonds recorded in the amount of $13.433 million, which represents the accreted value of these bonds. The accumulated accretion for the capital appreciation bonds is $10.924 million since May 24, 1989.

University Bonds

The *University of North Carolina at Chapel Hill, Series 1997 Utility System* and the *Series 1991 U. S. Environmental Protection Agency Project* bond issues include capital appreciation bonds with an ultimate maturity value of $84.135 million and $25.275 million, respectively. These bonds are recorded in the amounts of $33.214 million and $7.808 million, respectively, which is the accreted value at June 30, 1999. These bonds mature in the years from 2010 to 2021.

F. Demand Bonds

University Revenue Bonds

Athletic Facilities, Series 1998

On August 13, 1998, the University of North Carolina at Chapel Hill issued variable rate demand bonds in the amount of $14,995,000 that have a final maturity date of November 1, 2018. The bonds are subject to mandatory sinking fund redemption that begins on November 1, 2000. The proceeds of this issuance were used for certain additions and renovations to Kenan Memorial Stadium and constructing new facilities serving the Field Hockey and Soccer teams. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agent, Bank of America.

Under an irrevocable letter of credit issued by Wachovia Bank, N. A., the trustee is entitled to draw amounts sufficient to pay principal and interest on the bonds and amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase. The University is required to pay an annual commitment fee for the letter of credit of .26% of the amount of bonds then currently outstanding plus an amount for accrued interest.

The University has entered into a reimbursement agreement with Wachovia in which it has agreed that upon the earlier of termination of the letter of credit or one year from a purchase draw date to repay amounts that represent purchase drawings under the letter of credit. Interest at the rate of prime is payable quarterly and upon draw repayment. At June 30, 1999, no purchase drawings had been made under the letter of credit.

The letter of credit automatically extends so that termination will not occur until 364 days after notice is received from Wachovia that the letter of credit will not be extended. As of June 30, 1999, the earliest such termination date is June 29, 2000.

Parking System, Series 1997C

On June 19, 1997, the University of North Carolina at Chapel Hill issued variable rate demand bonds in the amount of $10,750,000 that have a final maturity date of May 15, 2027. The bonds are subject to mandatory sinking fund redemption that begins on May 15, 2000. The proceeds of this issuance are to be used for the construction of the Health Affairs parking deck adjacent to UNC Hospitals on the campus of the University. The bonds are subject to purchase on demand with seven days notice and delivery to the University's paying agent, The Bank of New York. Salomon Smith Barney, Inc. is the remarketing agent.

The University has arranged for a standby bond purchase agreement with Bank of America, whereby the bank agrees to purchase 1997C bonds when remarketing proceeds are not available. This liquidity facility provides moneys only with respect to the purchase price of the bonds and does not otherwise secure payment of the bonds. The University is required to pay an annual commitment fee for the liquidity facility of .10% of the amount of bonds then currently outstanding.

The University has agreed to pay interest on each liquidity bond at LIBOR (London Interbank Offering Rate) plus .50% on each scheduled bond interest payment date. At June 30, 1999, no bonds had been purchased under the liquidity facility.

The University is required to purchase or cause to be purchased any liquidity bonds purchased under the agreement upon expiration or termination of the agreement. The term of the agreement is automatically extended for successive 364-day periods from the closing date, unless a notice of non-extension by Bank of America is received 365 days prior to the expiration date. As of June 30, 1999, the earliest such termination date is June 30, 2000.

Kenan Stadium, Series 1996

On November 7, 1996, the University of North Carolina at Chapel Hill issued variable rate demand bonds in the amount of $13,800,000 that have a final maturity date of November 1, 2016. The bonds are subject to mandatory sinking fund redemption that began on November 1, 1998. The proceeds of this issuance were used for certain additions and renovations to Kenan Memorial Stadium. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agent, Bank of America.

Under an irrevocable letter of credit issued by Wachovia Bank, N.A., the trustee is entitled to draw amounts sufficient to pay principal and interest on the bonds and amounts sufficient to pay the purchase price and accrued interest on the bonds delivered for purchase. The University is required to pay an annual commitment fee for the letter of credit of .30% of the amount of bonds then currently outstanding plus an amount for accrued interest.

The University has entered into a reimbursement agreement with Wachovia Bank in which it has agreed that upon the earlier of termination of the letter of credit or one year from a purchase draw date to repay amounts that represent purchase drawings under the letter of credit. Interest at the rate of prime is payable quarterly and upon draw repayment. At June 30, 1999, no purchase drawings had been made under the letter of credit.

The letter of credit automatically extends so that termination will not occur until 364 days after notice is received from Wachovia that the letter of credit will not be extended. As of June 30, 1999, the earliest such termination date is June 29, 2000.

Ambulatory Care Clinic, Series 1990

On May 15, 1990, the University of North Carolina at Chapel Hill issued money market municipal demand bonds in the amount of $20,000,000 that have a final maturity date of July 1, 2012. The bonds are subject to mandatory sinking fund redemption that began on July 1, 1993. The proceeds of this issuance were used for financing the acquisition, construction, and equipping of clinical facilities at the University's School of Medicine and for paying the issuance costs of the 1990 bonds. The bonds were converted from money market municipal bonds to weekly rate bonds effective May 31, 1995. The bonds are subject to purchase on demand with seven days notice and delivery to the University's paying agent, Bankers Trust Company. Lehman Brothers, Inc. is the remarketing agent.

The University has arranged a standby bond purchase agreement with Bank of America, whereby the bank will purchase bonds on a purchase date at the purchase price when remarketing proceeds or other funds are not available. This liquidity facility pays only the principal portion of the purchase price and does not secure payment of the principal of or interest on the bonds. The University is required to pay an annual commitment fee for the liquidity facility of .10% of the amount of bonds then currently outstanding.

The University has agreed to pay interest on each liquidity bond at LIBOR plus .40% on each scheduled bond interest payment date. At June 30, 1999, no bonds had been purchased under the liquidity facility.

The University is required to purchase or cause to be purchased any liquidity bonds purchased under the agreement upon expiration or termination of the agreement. The term of the agreement is automatically extended for successive 364-day periods from the closing date, unless a notice of non-extension by Bank of America is received 365 days prior to the expiration date. As of June 30, 1999, the earliest such termination date is June 30, 2000.

NOTES TO THE FINANCIAL STATEMENTS

Ambulatory Care Clinic, Series 1992

On November 19, 1992, the University of North Carolina at Chapel Hill issued tax-exempt adjustable mode demand notes in the amount of $3,000,000 that have a final maturity date of October 1, 2002. The bonds are subject to mandatory sinking fund redemption that began on October 1, 1994. The proceeds of this issuance were used to provide equipment for the ambulatory care building used by UNC Physicians and Associates and to pay the issuance costs of the notes. The notes are subject to purchase on demand with seven days notice and delivery to the University's remarketing agent, Wachovia Bank, N. A.

The University has arranged a standby note purchase agreement with Wachovia Bank, N. A., whereby Wachovia will purchase notes tendered or deemed tendered for purchase on any purchase date at the purchase price plus accrued interest when remarketing proceeds or other funds are not available. The University is required to pay an annual commitment fee for the liquidity facility of .30% of the amount of notes then currently outstanding plus an amount for accrued interest.

Notes held by Wachovia under this liquidity facility are subject to mandatory redemption 180 days after the date of purchase by Wachovia at an amount equal to the principal plus accrued interest at the Adjusted Euro-Dollar rate. At June 30, 1999, no notes had been purchased under the liquidity facility.

The liquidity facility terminates not earlier than 180 days following delivery of a termination notice by Wachovia. As of June 30, 1999, the earliest such termination date is December 27, 1999.

Carolina Inn, Series 1994

On September 27, 1994, the University of North Carolina at Chapel Hill issued taxable flexible term demand bonds in the amount of $13,475,000 that have a final maturity date of November 15, 2019. The bonds are subject to mandatory sinking fund redemption that began on November 15, 1998. The proceeds of this issuance were used to renovate and expand the Carolina Inn and to pay the costs incurred in connection with the issuance of the bonds. The bonds are subject to purchase on each interest payment date and on delivery to the University's paying agent, The Bank of New York.

The University has arranged a standby bond purchase agreement with Bank of America, whereby Bank of America will purchase bonds on a purchase date at the stated amount of principal plus accrued interest when remarketing proceeds or other funds are not available. The University is required to pay an annual standby fee for the liquidity facility of .10% of the amount of bonds then currently outstanding plus an amount for accrued interest.

The University has agreed to pay interest on each liquidity bond at LIBOR plus .50% on each scheduled bond interest payment date. At June 30, 1999, no bonds had been purchased under the liquidity facility.

The University is required to purchase or cause to be purchased any liquidity bonds purchased under the agreement upon expiration or termination of the agreement. The term of this agreement is automatically extended for successive 364-day periods from the closing date, unless a notice of non-extension by Bank of America is received 365 days prior to the expiration date. As of June 30, 1999, the earliest such termination date is June 30, 2000.

School of Dentistry, Series 1995

On June 28, 1995, the University of North Carolina at Chapel Hill issued tax-exempt adjustable mode demand bonds in the amount of $4,000,000 that have a final maturity date of September 1, 2010. The bonds are subject to mandatory sinking fund redemption beginning on September 1, 1999. The proceeds of this issuance are for the construction of a building called Tarrson Hall, which will house the majority of the School of Dentistry's patient care and clinical teaching facilities. The bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agent, Wachovia Bank, N. A.

Under an irrevocable letter of credit issued by Wachovia Bank, N. A., the trustee is entitled to draw amounts sufficient to pay principal and interest on the bonds and amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase. The University is required to pay an annual commitment fee of .35% of the amount of the bonds then currently outstanding plus an amount for accrued interest.

The University has entered into a reimbursement agreement with Wachovia Bank in which it has agreed upon termination of the letter of credit to repay all amounts that are drawn under the letter of credit. Interest at the rate of prime for the first 90 days and prime plus 1.5% thereafter is payable quarterly and upon termination. At June 30, 1999, no drawings had been made under the letter of credit.

The letter of credit automatically extends every month so that termination will not occur until 13 months after notice is received from Wachovia that the letter of credit will not be extended. As of June 30, 1999, the earliest such termination date is July 5, 2000.

The University of North Carolina System Variable Rate Demand Pool Revenue Bonds, Series 1998A

On November 3, 1998, East Carolina University issued variable rate demand bonds in the amount of $3,645,000 that have a final maturity date of October 1, 2008. The bonds are subject to mandatory sinking fund redemption that begins on October 1, 1999. The proceeds of this issuance were used to refinance notes payable which were issued to pay the costs of repairs to Dowdy-Ficklen Stadium, construction of the Blount Intramural Field, and construction of the Reade Street Parking Lot. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days' notice and delivery to the University's remarketing agent, Salomon Smith Barney, Inc.

Under a standby bond purchase agreement issued by Bank of America, the trustee is entitled to draw amounts sufficient to pay principal and interest on the bonds and amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase. The University is required to reimburse the University of North Carolina System for annual commitment fees for the standby bond purchase agreement.

The University has entered into a reimbursement agreement with Bank of America in which it has agreed that upon the earlier of termination of the letter of credit or one year from a purchase draw date to repay amounts that represent purchase drawings under the letter of credit. Interest at the rate of prime is payable quarterly and upon draw repayment. At June 30, 1999, no purchase drawings had been made under the letter of credit.

The standby bond purchase agreement automatically extends so that termination will not occur until 364 days after notice is received from Bank of America that the agreement will not be extended. As of June 30, 1999, the earliest such termination date is June 29, 2000.

Athletic Department, Series 1996

On December 1, 1996, East Carolina University issued tax-exempt adjustable mode demand bonds in the amount of $7,000,000 that have a final maturity date of May 1, 2017. The bonds are subject to mandatory sinking fund redemption that began on May 1, 1998. The proceeds of this issuance were used to pay the cost of renovating and expanding Dowdy-Ficklen Stadium on the campus of East Carolina University and to pay the costs incurred in connection with the issuance of the 1996 bonds. The bonds are subject to purchase on demand with seven days' notice and delivery to the University's remarketing agent, Alex. Brown & Sons, Inc.

Under an irrevocable direct-pay letter of credit issued by Wachovia Bank, N.A., the trustee is entitled to draw amounts sufficient to pay principal and interest on the bonds and amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase. The University is required to pay an annual commitment fee of .30% of the amount of the bonds then currently outstanding plus an amount for accrued interest.

The University has entered into a reimbursement agreement with Wachovia Bank in which it has agreed upon termination of the letter of credit to repay all amounts that are drawn under the letter of credit. Interest is charged at the rate of prime. At June 30, 1999, no drawings had been made under the letter of credit.

The letter of credit automatically extends every month so that termination will not occur until 13 months after notice is received from Wachovia Bank that the letter of credit will not be extended. As of June 30, 1999, the earliest such termination date is July 31, 2000.

G. Debt Service Requirements

Bonds Payable and Notes Payable

The following schedule shows the annual debt service requirements to pay principal and interest on general obligation bonds and revenue bonds, as well as on notes payable, outstanding at June 30, 1999 (dollars in thousands). Current and long-term principal requirements are disclosed for the proprietary component unit funds.

	Bonds Payable				**Notes Payable**		
	Primary Government	*Component Units*			*Primary Government*	*Component Units*	
		Proprietary					
Fiscal Year	*General Long-Term Obligations Account Group*	*N. C. Housing Finance*	*Other Proprietary Funds*	*University Funds*	*General Long-Term Obligations Account Group*	*Proprietary Funds*	*College and University Funds*
2000	$ 260,582	$ 77,132	$ 28,346	$ 77,249	$ 2,376	$ 25,827	$ 9,050
2001	254,109	78,701	28,293	81,638	115	1,017	2,756
2002	247,245	78,632	29,221	81,272	115	778	2,495
2003	240,326	78,530	29,147	81,009	115	639	1,504
2004	233,496	77,482	62,277	80,482	115	134	1,399
2005-2009	1,067,491	379,153	171,538	377,915	574	402	5,326
2010-2014	872,040	372,767	116,344	315,236	554	—	1,112
2015-2019	365,884	363,224	231,315	231,830	—	—	528
2020-2024	—	328,625	66,255	135,234	—	—	317
2025-2029	—	239,358	321,969	49,715	—	—	—
2030-2034	—	21,825	—	—	—	—	—
Total requirements	3,541,173	2,095,429	1,084,705	1,511,580	3,964	28,797	24,487
Less:							
Interest requirements	(1,083,523)	(1,074,174)	(550,358)	(596,893)	(694)	(483)	(4,324)
Unamortized discount	(5,677)	—	—	(16,067)	—	—	—
Deferred charges	—	(20,118)	—	(256)	—	—	—
Underwriters fees	—	—	—	(710)	—	—	—
Total principal requirements	$ 2,451,973	$ 1,001,137	$ 534,347	$ 897,654	$ 3,270	$ 28,314	$ 20,163
Current portion		$ 77,132	$ 1,110			$ 22,825	
Long-term portion		$ 924,005	$ 533,237			$ 5,489	

H. Arbitrage Rebate Payable

The State and universities have incurred an arbitrage rebate liability in connection with general obligation and university revenue bonds sold in previous years. Arbitrage rebates payable at June 30, 1999 have been recorded (dollars in thousands) in the following funds:

Capital projects funds	$ 88
Special revenue funds	5,788
University funds	3,070
Total	$ 8,946

I. Bond Defeasances

State of North Carolina

On March 17, 1999, the State of North Carolina issued $25,905,000 in *Clean Water Refunding Bonds, Series 1999* with an average interest rate of 4.4563%. The refunding component of this bond issue was used to advance refund (defease) $24,000,000 of specific maturities of outstanding *Clean Water Bonds, Series 1994A* with an average interest rate of 5.7564% stated to mature on June 1, 2005 to 2016, inclusive. Net proceeds of $26,198,222, which includes a premium of $277,184 and accrued interest of $16,038, resulted from the bond sale. Of the net proceeds amount, $26,127,201 was used to purchase U.S. government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the specific maturities of *Clean Water Bonds, Series 1994A*. As a result, the specific maturities of *Clean Water Bonds, Series 1994A* are considered to be defeased and the liability for these bonds has been removed from the general long-term obligations account group. The State reduced its debt service requirements by $1,522,098 over the next 18 years and obtained an economic gain of $1,066,791. At June 30, 1999, the outstanding balance of the defeased bonds was $24,000,000. At June 30, 1999, the remaining balance (not defeased) of the *Clean Water Bonds, Series 1994A* in the general long-term obligations account group was $10,000,000.

North Carolina State University

On November 3, 1998, North Carolina State University issued $1,695,000 in *North Carolina State University at Raleigh Gymnasium System Revenue Refunding Bonds*, through the System Wide Financing, with an average interest rate of 4.27%. The refunding component of this bond issue was used to currently refund (defease) $4,840,000 of outstanding *North Carolina State University at Raleigh Gymnasium System Revenue Bonds, Series 1987* with a combined average interest rate of 5.85%. Net proceeds of $5,018,960 resulted from the bond sale. The University reduced its debt service requirements by $765,535 over the next 9 years and obtained an economic gain of $149,139.

Winston-Salem State University

On August 11, 1998, Winston-Salem State University issued $8,430,000 in *Winston-Salem State University Housing and Dining System Revenue Refunding Bonds, Series 1998B* with a weighted average interest rate of 4.72%. The refunding component of this bond issue was used to advance refund (defease) $7,615,000 of outstanding *Winston-Salem State University Housing and Dining System Revenue Bonds, Series 1992A* with a combined weighted interest rate of 6.37%. Net proceeds of $8,157,830 resulted from the bond sale. Of the net proceeds amount, $7,912,606 was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by $595,889 over the next 19 years and obtained an economic gain of $400,149. At June 30, 1999, the outstanding balance was $7,615,000 for the defeased *Winston-Salem State University Housing and Dining System Revenue Bonds, Series 1992A.*

North Carolina School of the Arts

On November 3, 1998, The North Carolina School of the Arts issued $1,080,000 in *Dormitory and Dining Hall System Revenue Refunding Bonds,* through the System Wide Financing, with an average interest rate of 4.37%. The refunding component of this bond issue, combined with other University funds, was used to currently refund (defease) $1,355,000 of outstanding *Dormitory and Dining Hall System Revenue Bonds, Series A*, with a combined average interest rate of 7.15%. Net proceeds of $1,074,474 resulted from the bond sale. The University reduced its debt service requirements by $446,940 over the next 11 years and obtained an economic gain of $341,716.

UNC Hospitals

On June 3, 1999, the Board of Governors of The University of North Carolina issued $58,925,000 in *Revenue Refunding Bonds, Series 1999* with a net interest cost of 5.07%. The refunding component of this bond issue was used to advance refund (defease) $55,595,000 of outstanding *Revenue Bonds, Series 1992* with a combined net interest cost of 6.25%. Net proceeds of $58,061,839 resulted from the bond sale. U.S. Government securities in the amount of $58,829,871 were purchased and placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. UNC Hospitals reduced its debt service requirements by $4,935,914 over the next 25 years and obtained an economic gain of $2,809,816. At June 30, 1999, the outstanding balance was $55,595,000 for the defeased *Revenue Bonds, Series 1992.*

NOTES TO THE FINANCIAL STATEMENTS

North Carolina Housing Finance Agency
On February 17, 1999, the North Carolina Housing Finance Agency issued $41,840,000 in *Single Family Revenue Bonds (1985 Resolution), Series WW* with an average interest rate of 6.25%, the proceeds of which were used to optionally redeem the *Single Family Revenue Bonds (1985 Resolution), Series G/H and I*. This refunding resulted in a deferred loss of approximately $741,200, of which $657,000 was unamortized bond issuance costs for the refunded issue. The refunding resulted in a decrease in total debt service payments of $19,689,000 and an economic gain of $2,832,000.

Prior Year Defeasances
During prior years, the State and certain component units defeased certain general obligation and other bonds. For those defeasances involving advance refundings, the proceeds and any securities purchased with the proceeds were placed in an irrevocable trust with an escrow agent in an amount sufficient to provide for all future debt service payments on the refunded bonds. Since adequate funds have been placed with a trustee to pay fully the principal and interest on these bonds, the liabilities are not recorded in these financial statements. At June 30, 1999, the outstanding balance of current and prior year defeased bonds was $83.6 million for the primary government and $153.2 million for the component units.

J. Bond Redemptions

Provisions of bond series resolutions for the North Carolina Housing Finance Agency provide for various methods of redemption. Bonds are redeemed at par from prepayments of mortgage loans securing the issues or from unexpended bond proceeds of the issues along with the related decreases in the respective debt service reserve requirements. In addition, various bond issues are redeemable at the option of the Agency at premiums ranging up to 10% during periods from 10 to 16 years after the date of issuance.

NOTE 8: INTERFUND RECEIVABLES AND PAYABLES

Interfund receivables and payables as of June 30, 1999 are as follows (dollars in thousands):

	Interfund Receivables	Interfund Payables
Primary Government		
General:		
General Fund	$ 84,711	$ 47,523
Special Revenue:		
State Highway Fund	10,202	86,250
Highway Trust Fund	72,749	—
Clean Water Management Trust Fund	—	2
Employment Security Commission Funds	2,143	—
Employment and Training Administration Fund	—	17
Highway Patrol Fund	—	61
Community Colleges Special Programs Fund	—	28,898
Wildlife Resources Commission Fund	356	704
Other Funds	4,852	2,574
Total Special Revenue Funds	90,302	118,506
Capital Projects:		
Capital Projects Fund	2,400	77
Total Capital Projects Funds	2,400	77
Enterprise:		
Public School Insurance	—	3
N.C. State Fair	—	6
Total Enterprise Funds	—	9
Internal Service:		
State Health Plan	—	1
State Property Fire Insurance	—	2,840
Prison Enterprises	6,835	78
Motor Fleet Management	4,844	371
Courier Service	—	53
Temporary Solutions	19	1
N.C. Information Highway	411	369
Centralized Computing Services	9,695	1,534
State Telecommunications Services	4,492	9
Applications Development Services	357	1,404
Decentralized Computing Services	1,731	—
Surplus Property	—	151
Total Internal Service	28,384	6,811
Expendable Trust:		
Unemployment Compensation Funds	—	74
Escheat Fund	25,710	14,531
Recreation and Natural Heritage Trust Fund	208	107
Other Funds	378	68
Total Expendable Trust	26,296	14,780

NOTES TO THE FINANCIAL STATEMENTS

	Interfund Receivables	Interfund Payables
Primary Government (continued)		
Nonexpendable Trust:		
Wildlife Endowment Program	—	1
Clean Water Revolving Loan and Grant Fund	—	1
Total Nonexpendable Trust	—	2
Pension Trust Funds:		
Firemen's and Rescue Squad Workers' Pension Fund	—	1
Agency:		
Local Sales Tax Collections	6,554	—
Clerks of Court	325	2,486
Departmental Agency Funds	50	11,147
Total Agency	6,929	13,633
Component Units		
Proprietary:		
N.C. Housing Finance Agency	—	3
North Carolina Railroad Company	—	62,843
N.C. Global TransPark Authority	—	25,710
State Education Assistance Authority	14,531	—
Total Proprietary Funds	14,531	88,556
College and University:		
University Funds	75,742	63,345
Community Colleges Funds	29,426	3,653
Total University and Community College	105,168	66,998
Subtotal	$ 358,721	$ 356,896
Timing difference — North Carolina Railroad Company	—	1,825
Total	$ 358,721	$ 358,721

Included in the category of interfund receivables are *"Due from other funds," "Due from component units," "Due from primary government,"* and *"Advance to component units."* Included in the category of interfund payables are "*Due to other funds*," "*Due to component units*," "*Due to primary government*," and "*Advance from primary government*." Interfund receivables exceeded interfund payables in the amount of the General Fund's $1.825 million of interest (*Due from component unit*) on the $61 million advance to the North Carolina Railroad Company (Railroad), a discretely presented component unit. This difference is the result of different fiscal years of the State and the Railroad. The Railroad's financial statements are as of and for the fiscal year ended December 31, 1998.

NOTE 9: RETIREMENT PLANS

The State reports seven retirement plans as pension trust funds. This note describes the six defined benefit public employee retirement plans administered by the State. The remaining plan, described in Note 10, is the Supplemental Retirement Income Plan, a defined contribution plan provided under the Internal Revenue Code Section 401(k). Although the assets of the six defined benefit plans are commingled for investment purposes, each plan's assets may be used only for payment of benefits to the members of that plan and for administrative costs, in accordance with the terms of the plan. Separate reports are not issued for the plans described in this note. The State also provides an optional retirement plan for certain university employees and a special separation allowance for eligible sworn law enforcement officers.

A. Plan Descriptions and Contribution Information

1. *TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM*

This plan is a cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State, its component units, and local boards of education not in the reporting entity. Membership is comprised of employees of state agencies and institutions, local boards of education, universities and community colleges and certain proprietary component units. At June 30, 1999, the number of participating local boards of education and component unit employers was 196 as shown below:

Local boards of education.................	117
Community colleges	58
University of North Carolina system	17
Proprietary component units.............	4

Benefits and administrative expenses are funded by member contributions of 6% of compensation and by employer contributions of 7.42% of covered payroll for the period July 1, 1998 through June 30, 1999, in addition to investment income. Benefit and actuarially based contribution provisions are established by G.S. 135-5 and 135-8 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

2. *CONSOLIDATED JUDICIAL RETIREMENT SYSTEM*

This plan is a single-employer, defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State Judicial System. Membership is comprised of judges, district attorneys and clerks of court. The plan provides retirement, disability and death benefits. Benefits and administrative expenses are funded by member contributions of 6% of compensation and employer contributions of 16.97% of covered payroll, for the period July 1, 1998 through June 30, 1999, in addition to investment income. Benefit and the actuarially based contribution provisions are established by G.S. 135-57, 135-58, 135-68 and 135-69 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

3. *LEGISLATIVE RETIREMENT SYSTEM*

This plan is a single-employer, defined benefit plan established by the State of North Carolina to provide retirement and disability benefits for members of the General Assembly.

The benefit will not be payable while the member is employed in a position making him eligible to participate in either the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System or the Local Governmental Employees' Retirement System. The plan's benefits and administrative expenses are funded by member contributions of 7% of compensation and employer contributions of 22.58% of covered payroll for the period July 1, 1998 to June 30, 1999, in addition to investment income. Benefit and actuarially based contribution provisions are established by G.S. 120-4.21, 120-4.19 and 120-4.20 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

NOTES TO THE FINANCIAL STATEMENTS

OTHER STATE ADMINISTERED SYSTEMS

The State also administers the following pension and retirement plans for persons who are not considered employees of the State or its component units.

4. FIREMEN'S AND RESCUE SQUAD WORKERS' PENSION FUND

This plan is a defined benefit pension plan established by the State of North Carolina to provide pension benefits for all eligible firemen and rescue squad workers. Membership is composed of both volunteer and locally employed firemen and emergency medical personnel who elect membership. At June 30, 1999, there were 1,447 participating fire and rescue units. This is a special funding situation in that the State is not the employer but is legally obligated to contribute to the plan.

Benefits and administrative expenses are funded by a $10 monthly contribution by the member, investment income and an actuarially based state appropriation. Benefit and contribution provisions are established by G.S. 58-86 and may be amended only by the North Carolina General Assembly.

5. NATIONAL GUARD PENSION FUND

This plan is a defined benefit plan established by the State of North Carolina to provide pension benefits for members of the North Carolina national guard. This is also a special funding situation, because the State is not the employer but is legally obligated to contribute to the plan.

Benefits and administrative expenses are funded by an actuarially based state appropriation and investment income. Benefit and contribution provisions are established by G.S. 127(a)-40 and may be amended only by the North Carolina General Assembly.

6. LOCAL GOVERNMENTAL EMPLOYEES' RETIREMENT SYSTEM

This plan is a cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina for employees of local governments. Membership is comprised of general employees and local law enforcement officers of participating local governmental entities.

At June 30, 1999, the number of participating local governments was 851, as shown below:

Cities	390
Counties	100
Special districts	361

The plan provides retirement benefits nearly identical to the benefits that accrue to members of the Teachers' and State Employees' Retirement System. This plan also provides disability benefits for members who become totally and permanently disabled from performing their usual job. Benefits and administrative expenses are funded by employee contributions of 6% and actuarially based employer contributions. Employers contribute 5.27% of covered payroll for law enforcement officers and 4.80% for general employees and firemen for normal costs and an unfunded liability rate, which is established when the government initially enters the system. The State's responsibility is administrative only. Benefit and contribution provisions are established by G.S. 128-27 and 128-30 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains.

The following table summarizes membership information by plan at the actuarial valuation date:

	Teachers' and State Employees'	*Judicial*	*Legislative*	*Firemen's, Rescue*	*National Guard*	*Local Governmental*
Employee Groups						
Retirees and beneficiaries currently receiving benefits	97,820	343	181	7,353	1,807	26,975
Terminated employees entitled to benefits but not yet receiving them	34,747	40	87	155	5,003	10,353
Active plan members	278,558	478	167	26,820	6,596	108,904
Total	411,125	861	435	34,328	13,406	146,232
Date of Valuation	*12-31-98*	*12-31-98*	*12-31-98*	*6-30-98*	*12-31-98*	*12-31-98*

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PLAN ASSET MATTERS

BASIS OF ACCOUNTING

The financial statements of these plans are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

INVESTMENTS

Pursuant to North Carolina General Statutes, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains an investment pool in which the systems participate. The investment balance of each system represents its share of the fair value of the net assets of various portfolios within the pool. Additionally, the investment balance also includes assets occurring from securities lending transactions resulting from the systems' participation in the pool. The investments of the State Treasurer are fully discussed in Note 4.

No retirement system has investments in any single commercial or industrial organization whose fair value would amount to more than five percent of the system's net assets available for benefits.

C. Actuarial Methods and Assumptions

The latest actuarial valuations are dated December 31, 1998 (June 30, 1998, for Firemen's and Rescue Squad Workers' Fund). The actuarial accrued liability and the schedule of funding progress are presented by system in the required supplementary section of this report. The actuarial value of assets for all systems is based on a five-year smoothed market value. Under this method, realized and unrealized gains and losses on investments are smoothed over five years. Below are listed the various actuarial methods and significant assumptions for these valuations that will be used to determine future annual required contributions.

							Actuarial Assumptions	
Retirement System	*Valuation Date*	*Actuarial Cost Method*	*Amortization Method*	*Remaining Amortization Period*	*Period Open/Closed*	*Asset Valuation Method*	*Investment Rate of Return*	*Projected Salary Increase*
Teachers' and State Employees'	12/31/98	Entry age	Level dollar	2 years	Open	5 year smoothed	7.25%	5.45-12.08%
Consolidated Judicial	12/31/98	Projected unit credit	Level percentage	14 years	Open	5 year smoothed	7.25%	5.63-12.58%
Legislative	12/31/98	Projected unit credit	Level dollar	None	Open	5 year smoothed	7.25%	7.50%
Firemen's, Rescue Squad Workers'	6/30/98	Entry age	Level dollar	5 years	Open	5 year smoothed	7.25%	N/A
National Guard	12/31/98	Entry age	Level dollar	6 years	Open	5 year smoothed	7.25%	N/A
Local Governmental Employees'	12/31/98	Frozen entry age	Level percentage	Various	Closed	5 year smoothed	7.25%	5.45-12.08%

N/A-Not applicable

NOTES TO THE FINANCIAL STATEMENTS

The valuation for the Local Governmental Employees' system includes a 1.0% cost of living increase enacted by the General Assembly effective July 1, 1999. The valuations for the Teachers' and State Employees', Consolidated Judicial, and Legislative Retirement systems reflect legislation that authorized a 2.3% cost of living increase (also effective July 1, 1999) for retirees in these systems. The projected investment returns and projected salaries for all systems, except the Legislative, include a 3.75% inflationary factor within the actuarial assumption. The assumption for the Legislative system does not identify an inflationary factor.

CURRENT FISCAL YEAR ASSUMPTIONS

The annual required contributions for the fiscal year ended June 30, 1999, were developed from various prior year valuations. The Teachers' and State Employees', Local Governmental Employees', Consolidated Judicial, and National Guard systems' valuations were as of December 31, 1996, the Legislative system was valued at December 31, 1997, and the Firemen's and Rescue Squad Worker's Fund was valued at June 30, 1997. These valuations used amortization periods of 2 years for Teachers' and State Employees', 40 years for Consolidated Judicial, 8 years for National Guard and 4 years for the Firemen's and Rescue Squad Worker's Fund. The Local Governmental Employees' system is an aggregate of numerous employers and consequently had various amortization periods. The contribution rates developed from these valuations assumed an investment return rate of 7.5% and basically the same salary increases as the most current valuations.

Unless otherwise noted in this footnote or in the required supplementary schedules, the actuarial values, methods and significant assumptions for the current year's required contributions are the same as those presented in the table shown on the prior page. The Teachers' and State Employees', Local Governmental Employees', Consolidated Judicial and Legislative Retirement systems were amended effective July 1, 1998, to provide a 2.5% post-retirement benefit increase. Additional benefit enhancements increased the benefit accrual rate in the Local Governmental Employees' system from 1.76% to 1.77%. The liabilities for these enhancements were reflected in the December 31, 1997, individual systems' valuations or paid for with actuarial gains. Also effective July 1, 1998, the Firemen's and Rescue Squad Worker's Fund increased the monthly benefit from $141 to $146. The cost of this amendment was covered by gains developed during the 1997 plan year.

D. Annual Pension Cost and Net Pension Obligation

The annual pension costs and net pension obligations for the State's single-employer and special funding defined benefit plans for the current fiscal year are as follows:

	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund
Annual required contribution	$ 7,263,051	$ 770,297	$ 12,104,780	$ 2,533,438
Interest on net pension obligation	—	(36,355)	—	—
Adjustment to annual required contribution	—	123,206	—	—
Annual pension cost	7,263,051	857,148	12,104,780	2,533,438
Contributions made	7,263,051	801,535	12,104,780	2,533,438
Increase (decrease) in net pension obligation		55,613		
Net pension (asset) obligation beginning of year	—	(501,447)	—	—
Net pension (asset) obligation end of year	$ —	$ (445,834)	$ —	$ —

NOTES TO THE FINANCIAL STATEMENTS

The following table presents the required three year trend of pension costs for the State's single-employer and special funding defined benefit plans and the required contributions the State made to the Teachers' and State Employees' Retirement System (the System), a cost-sharing, multiple-employer plan. The State's contribution equals its pension expense/expenditures for the System. The State does not make any contributions to the Local Governmental Employees' System; therefore, it does not have any related pension cost.

State of North Carolina's Annual Pension Cost (APC)
and Annual Required Contributions (ARC) as an Employer
For the Years Ended June 30, 1997 through June 30, 1999 (in thousands)

	Teachers' and State Employees'	*Judicial*	*Legislative*	*Firemen's, Rescue*	*National Guard*
Primary Government:					
1999	$ 174,028	$ 7,263	$ 857	$ 12,105	$ 2,533
1998	172,530	8,485	833	11,735	2,533
1997	170,342	7,976	840	11,735	2,303
Component units:					
Universities:					
1999	$ 79,770				
1998	79,572				
1997	79,168				
Community Colleges:					
1999	$ 29,772				
1998	28,953				
1997	28,432				
Proprietary Funds:					
1999	$ 1,075				
1998	1,038				
1997	1,141				
Total Primary Government and Component Units:					
1999	$ 284,645	$ 7,263	$ 857	$ 12,105	$ 2,533
1998	282,093	8,485	833	11,735	2,533
1997	279,083	7,976	840	11,735	2,303
Percentage of APC Contributed:					
1999		100%	94%	100%	100%
1998		100%	96%	100%	100%
1997		100%	95%	100%	100%
Percentage of ARC Contributed:					
1999	100%				
1998	100%				
1997	100%				
Net Pension (Asset) Obligation:					
1999		$ —	$ (446)	$ —	$ —
1998		—	(501)	—	—
1997		—	(534)	—	—

The pension liabilities for the transition year (1997) were determined in accordance with GASB 27. The prior year pension liability and current pension liability for all systems, except Legislative, are zero. Each year's APC and net pension asset for the Legislative System were calculated in accordance with GASB 27 back to 1993 and contain the cumulative effect of applying this statement.

E. Optional Retirement Plan

The Optional Retirement Program (Program) is a defined contribution retirement plan which provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Faculty and administrators with faculty rank in universities of the UNC system may join the Program instead of the Teachers' and State Employees' Retirement System. At June 30, 1999, the Plan had 7,679 participants.

Benefits are provided by means of contracts issued and administered by the privately-operated Teachers' Insurance and Annuity Association and the College Retirement Equities Fund (TIAA/CREF), Valic, and Lincoln National Life Insurance Company. Participants' eligibility and contributory requirements are established in G.S. 135-5.1. Participants contribute 6% of compensation and the university contributes 6.84%. There is no liability other than the universities' required contributions. The universities contributed $39,141,182 for the 1998-99 fiscal year. Annual covered payroll was $572,239,497 and employer contributions expressed as a percentage of annual covered payroll were 6.84% for the fiscal year ended June 30, 1999. Employee contributions expressed as a percentage of annual covered payroll were 6%, with an actual employee contribution of $34,334,370 for the 1998-99 fiscal year.

Participants are vested after five years of service, but the company must return the value of the universities' contributions to the State if termination occurs prior to five years of service. The participant chooses his/her own investment products with the company of choice.

F. Special Separation Allowance

The State provides a special separation allowance (SSA), an agent multiple-employer, defined benefit pension plan, for sworn law enforcement officers as defined by G.S. 135-1(11b) or G.S. 143-166.30(a)(4) that were employed by State agencies and component units and retired on a basic service retirement under the provisions of G.S. 135-5(a). To qualify for the allowance, each retired officer must: (1) have completed 30 or more years of creditable service or have attained 55 years of age and completed five or more years of creditable service; and (2) not have attained 62 years of age; and (3) have completed at least five years of continuous service as a law enforcement officer immediately preceding a service retirement. Each eligible officer is paid an annual separation allowance equal to .85% of the officer's most recent base rate of compensation for each year of creditable service. For the fiscal year ended June 30, 1999, the State and its component units paid $7,220,781 for 621 retired law enforcement officers. These benefits are funded on a pay-as-you-go basis with each employer (the State or component unit) responsible for the benefits to their former employees. There is no statewide administration of the SSA and there is no actuarial valuation performed. Funds for this allowance are appropriated annually in the budget of each state agency or paid from the component unit's operations for those employers who have eligible, retired law enforcement officers. These benefits are established in G.S. 143-166.41 and may be amended only by the General Assembly.

NOTE 10: DEFERRED COMPENSATION PLANS

IRC Section 457 Plan – General Statute 143B-426.24 authorized the creation of the Board of Trustees of the North Carolina Public Employee Deferred Compensation Plan (the Board). The Board was established as an agency of the State under the Department of Administration to offer the State's permanent employees, university employees, and the employees of certain other component units, a uniform Deferred Compensation Plan (the Plan) in accordance with Internal Revenue Code Section 457. The Plan permits each participating employee to defer a portion of his or her salary until future years by having the funds invested in various instruments that make up the North Carolina Public Employee Deferred Compensation Trust Fund. This fund is held in trust by the Plan for the exclusive benefit of participating employees and their beneficiaries. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board. The Board has delegated the general administration of the Plan to a third party but has retained all statutory authority and fiduciary responsibility for major decisions of the Plan. The Plan is reported in the CAFR as an expendable trust fund. All costs of administering and funding the Plan are the responsibility of the plan participants.

IRC Section 401(k) Plan - Effective January 1, 1985, Chapter 135, Article 5 of the North Carolina General Statutes authorized the creation of the Supplemental Retirement Income Plan of North Carolina (the Plan) in accordance with Internal Revenue Code Section 401(k). All members of the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System, Legislative Retirement System, Local Governmental Employees' Retirement System and University Optional Retirement Program are eligible to enroll in this plan and may contribute up to 20% (limited to $10,000 in 1998) of their compensation during the plan fiscal year. Members of the Plan may receive their benefits upon retirement, disability, termination, hardship, or death. All contributions and costs of administering the Plan are the responsibility of the participants.

The Plan is a defined contribution pension plan that is administered by a third party. The administrator prepares financial statements based on the plan fiscal year. The audited statements for the year ended December 31, 1998, are presented in this financial report as a pension trust fund. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. The Plan's financial statements are prepared using the accrual basis of accounting. Investments are reported at fair value. Securities and mutual funds are based on published quotations while bank investment contracts are stated at contract value. Notes Receivable represent loans to participants and are reported at outstanding principal balances. The plan is administered by the Branch Banking and Trust Company (BB&T) and the Plan's financial statements are available by contacting the N.C. 401(k) Plan, P.O. Box 29541, Raleigh, NC 27626.

In addition to the voluntary contribution criteria above, G.S. 143-166.30 requires state contributions to the Plan to provide benefits for all law enforcement officers employed by the State and its component units. G.S. 143-166.50 requires local governmental units with law enforcement officers to also contribute at least as much as the State. Participation begins at the date of employment. State agencies and component units are required to contribute monthly to the individual accounts of participants an amount equal to 5% of each officer's monthly salary. The State is also required to contribute to the individual accounts of all officers on a per capita basis in equal shares. State law enforcement officers receive $.50 for each court cost assessed and collected under G.S. 7A-304, while $1.25 of this assessment goes to local law enforcement officers. General Statutes allow law enforcement officers to voluntarily contribute up to 10% of their compensation within any calendar year, but current Internal Revenue Code restrictions limit the actual voluntary contribution a law enforcement officer can make. All contributions are immediately vested in the name of each participant. At December 31, 1998, 40 state agencies and component units along with 484 local governmental units outside our reporting entity contributed the required 5%. In addition, 240 local government employers contributed to the Plan on a voluntary basis.

At December 31, 1998, the Plan disclosed the following investments (at fair value) exceeding five percent of the Plan net assets:

BB&T Money Rate Savings Accounts	$ 163,429,000
BB&T Bank Investment Contracts	322,715,000
Fidelity Equity-Income Fund	284,703,000
Fidelity Magellan Fund	771,928,000
Fidelity Spartan U.S. Equity	145,926,000

The Plan also reported total member contributions of $121,130,000. The payrolls for law enforcement officers, on which the required contributions were based for the year ended December 31, 1998, amounted to $117,594,768 for the State, $11,424,569 for universities, and $822,096 for the other miscellaneous component units. The required 5% employer's contribution was made by the State for $5,879,738, by universities for $571,228, and by the remaining component units for $41,105. In addition, the State contributed $499,663 for the required court cost assessments.

IRC Section 403(b) Plans - Employees of the UNC system and community colleges can participate in tax-sheltered annuity contracts and custodial accounts created under Internal Revenue Code (IRC) Section 403(b). Generally all employees are eligible, but the IRC does allow the establishment of a minimum contribution of $200 and the exclusion from participation of certain classes of employees. Each institution may exclude one or more of these classes if every employee within the institution meeting the class criteria is excluded from participation. The employees' eligible contributions, made through salary reduction agreements, are exempt from federal and state income taxes until the accumulated balances are received or the contributions are withdrawn. Effective January 1, 1989, contributions may be withdrawn by employees only upon separation from service, death, disability, reaching age 59 1/2 or age 55 with qualifying retirement, or due to certain financial hardships. Currently, there is no restriction on the withdrawal of the value of annuity contracts. Custodial accounts established as of December 31, 1988 can be withdrawn only in respect to hardship established as of December 31, 1988. These plans are exclusively for employees of public educational organizations and certain charitable and other non-profit institutions as defined by the IRC. Since all contributions are made voluntarily by employees, all costs are borne by the plans' participants. No direct costs are incurred by the State.

NOTE 11: OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees

The State Health Plan provides postemployment health insurance to former employees of the State, the University of North Carolina system, community colleges, certain participating proprietary component units, and Local Education Agencies (LEAs) which are not part of the reporting entity. Those former employees who are eligible to receive health care as an other postemployment benefit are long-term disability beneficiaries of the Disability Income Plan of North Carolina (DIPNC) and retirees of the Teachers' and State Employees' Retirement System (TSERS), the Consolidated Judicial Retirement System (CJRS), the Legislative Retirement System (LRS), and the University Employees' Optional Retirement Program (UEORP), with five or more years of contributory membership service in the Retirement System prior to disability or retirement. For the fiscal year ended June 30, 1999, the number of participants currently eligible to receive health care as an other postemployment benefit are 40,702 TSERS and DIPNC members (excluding LEA members), 237 CJRS members, 126 LRS members, and 457 UEORP members. The health insurance plan is the same as for active employees as described in Note 12, except that the coverage becomes secondary when former employees become eligible for Medicare. These former employees are eligible to participate in either the self-funded Comprehensive Major Medical Plan (Plan) or one of the health maintenance organization (HMO) plans.

The funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. These health care benefits are funded by employer contributions that are established in the biennial appropriation bill by the General Assembly. The State, participating component units, and LEAs contributed a monthly amount equal to 2.0% of active employees' salaries to the General Fund's Reserve for Retirees' Health Premium Account (Reserve). The Reserve pays the full cost of coverage for long-term disability beneficiaries and retirees enrolled in the Plan and makes similar contributions for long-term disability beneficiaries and retirees enrolled in the HMO plans. Long-term disability beneficiaries and retirees pay for the additional cost of HMO coverage in excess of the Reserve's contribution and for the entire cost of coverage for their spouses and dependents. For the fiscal year ended June 30, 1999, the Reserve paid $1,320.96 for each Medicare-eligible long-term disability beneficiary and retiree and $1,735.20 for each non-Medicare-eligible long-term disability beneficiary and retiree. At June 30, 1999, the Reserve had net assets at fair value of $297,660,636. The net assets are available for future benefit payments. For the fiscal year ended June 30, 1999, contributions on behalf of former employees of the reporting entity were made to the Reserve as follows:

Primary government	$ 47,834,781
University of North Carolina system	32,792,381
Community colleges	8,024,679
Certain participating proprietary component units	289,639
Total contributions	$ 88,941,480

These benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly.

B. Disability Income

As discussed in Note 12, short-term and long-term disability benefits are provided to the eligible members of the Teachers' and State Employees' Retirement System and the University Employees' Optional Retirement Program through the Disability Income Plan of North Carolina (DIPNC), an internal service fund. Long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five or more years of contributing membership service in the Teachers' and State Employees' Retirement System of North Carolina (Retirement System) or the University Employees' Optional Retirement Program, earned within ninety-six months prior to the end of the short-term disability period or cessation of salary continuation payments, whichever is later; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period or after salary continuation payments cease or after monthly payments for Workers' Compensation cease (excluding monthly payments for permanent partial benefits), whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of his/her usual occupation; (4) the disability must have been continuous, likely to be permanent, and incurred at the time of active employment; (5) the employee must not be eligible to receive an unreduced retirement benefit from the Retirement System; and (6) the employee must terminate employment as a permanent, full-time employee. An employee is eligible to receive an unreduced retirement benefit from the Retirement System after (1) reaching the age of 65 and completing five years of creditable service, or (2) reaching the age of 60 and completing 25 years of creditable service, or (3) completing 30 years of creditable service, at any age.

The monthly long-term disability benefit is equal to 65% of one-twelfth of an employee's annual base rate of compensation last payable to the participant or beneficiary prior to the beginning of the short-term disability period, plus the like percentage of one twelfth of the annual longevity payment to

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which the participant or beneficiary would be eligible. The monthly benefits are subject to a maximum of $3,900 per month reduced by any primary Social Security disability benefits and by monthly payments for Workers' Compensation to which the participant or beneficiary may be entitled, but the benefits payable shall be no less than $10 a month. When an employee qualifies for an unreduced service retirement allowance from the Retirement System, the benefits payable from DIPNC will cease, and the employee will commence retirement under the Teachers' and State Employees' Retirement System or the University Employees' Optional Retirement Program.

Long-term disability income benefits are advance-funded on an actuarially determined basis using the one-year term cost method. Disability income benefits are funded by employer contributions that are established in the Appropriations Bill by the General Assembly. For the calendar year ended December 31, 1998, the State, the University of North Carolina system, community colleges, and certain participating proprietary component units, and LEAs contributed .52% of active employees' salaries to fund the disability benefits. The contributions cannot be separated between the amounts that relate to other postemployment benefits and employment benefits for active employees.

At December 31, 1998, DIPNC had 2,210 members, excluding LEA members, who were currently eligible to receive disability benefits as an other postemployment benefit out of a total of 243,595 active plan participants. Those individuals who are receiving extended short-term disability benefit payments cannot be separated from the number of members currently eligible to receive disability benefits as an other postemployment benefit.

The basis for estimating the liabilities for unpaid claims is discussed in Note 12. The market related actuarial value of the assets of DIPNC at December 31, 1998, was $176,946,348 creating a deficit of $39,485,561. The fair value of the assets for DIPNC at December 31, 1998 was $193,681,592. The assets are available for future other postemployment benefits and benefits for eligible active employees.

~~Actuarial Assumptions for the calendar year ended December 31, 1998:~~

Discount rate	7.25%
Rate of return on investments assumption	7.25%
Projected salary increase assumption	5.75%
Projected social security benefits increase assumption	3.75%
Social security assumption	75%
Actuarially required contribution	$22,502,404
Actual contribution made by:	
Primary Government	$11,904,888
University of North Carolina system	8,503,451
Community Colleges	2,018,698
Certain participating proprietary component units	75,367
Total actual contribution made	$22,502,404

These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

NOTE 12: RISK MANAGEMENT AND INSURANCE

A. Public Entity Risk Pool

1. Public School Insurance Fund

The Public School Insurance Fund (the Fund) is a public entity risk pool reported within the enterprise funds. In accordance with Chapter 115C, Article 38, of the General Statutes, the purpose of the Fund is to insure the Local Education Agencies (LEAs), which are not a part of the reporting entity. The community colleges, which are component units, can also acquire insurance through the Fund as stated in G.S. 115D-58.11(c). The board of each LEA and the board of trustees of each community college are required to carry extended coverage against fire and lightning damage to the extent of not less than seventy-five percent (75%) of the current insurable value for each insurable building. The boards also are to insure adequately the equipment and contents of said building. The Fund is financed by premiums collected from the LEAs and the community colleges and interest earned on the Fund's cash balance. Each board has to give notice of its election to insure in the Fund at least 30 days prior to such insurance becoming effective and shall furnish to the State Board of Education a full and complete list of all outstanding fire insurance policies. While the said insurance policies remain in effect, the Fund shall act as coinsurer of the properties covered by such insurance. The Fund currently insures 103 out of 116 LEAs and 22 out of 58 community colleges.

Claim liabilities are based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. There are no salvage claims anticipated since any salvage is adjusted in the claim settlement. There are no subrogation claims pending. Since claims are reviewed by adjusters and the actual loss projection is computed in a short time after the claim is reported, the claim adjustment expense associated with the unpaid claim liability will be reflected in the current period. The Fund does consider investment income in determining if a premium deficiency exists.

The only acquisition costs are related to proposal costs and inspection costs for new insurance. Since the Fund can only insure the LEAs and the community colleges, new contracts are immaterial. Since existing contracts are renewed once a year, the Fund's costs are for policy maintenance. Therefore, acquisition costs do not need to be amortized.

The following schedule shows the changes in the reported liability for the past two years (dollars in thousands):

	Fiscal Year 1999	Fiscal Year 1998
Unpaid claims at beginning of year	$ 4,166	$ 4,904
Incurred claims:		
Provision for insured events of the current year	4,916	5,510
Increases (decreases) in provision for insured events of prior years	(868)	(644)
Total incurred claims	4,048	4,866
Payments:		
Claims attributable to insured events of the current year	4,077	2,044
Claims attributable to insured events of the prior years	2,825	3,560
Total payments	6,902	5,604
Total unpaid claims at end of the year	$ 1,312	$ 4,166

With the collection of premiums from the insured educational units, payment of valid claims becomes the responsibility of the Fund. All claims greater than $10 million per occurrence (up to $30 million per location) are covered by reinsurance policies. Total payments by the Fund over $20 million a year (March 20, 1998 - March 20, 1999) are also paid by the reinsurers. Maximum recoverable from the reinsurers for any one catastrophe is $1 billion per occurrence, or a $300 million maximum on a flood or earthquake. Incurred losses are reduced by estimated amounts recoverable under the Fund’s reinsurance policies. Currently there are claims recoverable from the reinsurers for an estimated $357,000.

On September 15, 1999, Hurricane Floyd hit North Carolina affecting numerous counties within the State. Preliminary estimates of damages caused by the hurricane are in excess of $12 million. Several counties have not yet been assessed and estimated damages are expected to increase.

B. Employee Benefit Plans

1. State Health Plan

In accordance with Chapter 135, Article 3, Part 3, of the General Statutes, the State provides comprehensive major medical care for employees and retirees of the State and its participating component units, as well as their dependents. This care is also extended to employees and retirees of the Local Education Agencies (LEAs), which are not part of the State's reporting entity. Coverage is self-funded by contributions to the State Health Plan (the Plan), an internal service fund of the State. Contributions for employee and retiree coverage are made by the State, its participating component units, and LEAs. Contributions for dependent coverage are made by employees and retirees. As described in Note 11, coverage is also extended to certain individuals as an other postemployment benefit. The Plan is administered by a third party who is responsible for the processing of claims and administration of cost containment. Health care is also made available through contractual agreements with health maintenance organizations (HMO). Monthly premium payments transfer the risk for health coverage to the Plan. The Plan does not assume risk for HMO contracts.

The Plan pays most expenses that are medically necessary and eligible for coverage based on usual, customary and reasonable allowances. Claims are subject to specified annual deductible and copayment requirements. The Plan disallows claims in excess of a lifetime maximum of $2 million.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). Changes in the Plan's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
1997-98	$ 111,334	$ 643,915	$ 643,544	$ 111,705
1998-99	111,705	734,552	709,856	136,401

2. Death Benefit Plan of North Carolina

Term life insurance (death benefits) is provided through the Death Benefit Plan, an internal service fund, to all members of the Teachers' and State Employees' Retirement System who have completed at least one full calendar year of membership in the System. Membership includes employees of the State, the University of North Carolina system, community colleges, and certain participating proprietary component units and Local Education Agencies (LEAs) which are not part of the reporting entity. The benefit payment is equal to the greater of (1) the compensation on which contributions were made by the member during the calendar year preceding the year in which his/her death occurs or (2) the member's highest twelve month's salary in a row during the twenty-four months prior to his/her death. The benefit is subject to a minimum of $25,000 and to a maximum of $50,000.

Death benefits are funded by actuarially based employer contributions that are established in the biennial appropriation bill by the General Assembly. The State, the University of North Carolina system, community colleges, and certain participating proprietary component units and LEAs contributed .16% of active employees' salaries to fund the Death Benefit Plan for the calendar year ended December 31, 1998.

These benefits are established by Chapter 135, Section 5(l), of the General Statutes and may be amended only by the North Carolina General Assembly. Claims liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
1997-98	$ 2,420	$ 22,301	$ 22,441	$ 2,280
1998-99	2,280	22,436	22,903	1,813

3. Disability Income Plan of North Carolina

Short-term and long-term disability benefits are provided through the Disability Income Plan of North Carolina (DIPNC), an internal service fund, to the eligible members of the Teachers' and State Employees' Retirement System which includes employees of the State, the University of North Carolina system, community colleges, certain participating proprietary component units, and Local Education Agencies (LEAs) which are not part of the reporting entity, and the University Employees' Optional Retirement Program. Short-term benefits are payable after a waiting period of 60 continuous calendar days from the onset of disability, which is determined as the last actual day of service or the day succeeding at least 365 calendar days after the commencement of service, whichever is later. Short-term benefits are provided to currently active employees and the related liability is not measurable. As discussed in Note 11, long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

Claim liabilities for long-term disability benefits are actuarially estimated using the one-year term cost method. These liabilities represent the present value of future claim payments obligated to members who have become disabled. The claim liabilities are separated into the following two classifications: (1) approved claim liabilities are for long-term disabilities that have occurred, have been approved, and are in long-term payment status; and (2) incurred but not reported (IBNR) liabilities are for disabilities that have occurred but are not in payment status. The IBNR liabilities are estimated based on the historical claims experience of DIPNC.

Significant actuarial assumptions used to estimate claim liabilities are presented in Note 11. Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
1997-98	$ 211,382	$ 65,244	$ 44,334	$ 232,292
1998-99	232,292	31,061	46,921	216,432

C. Other Risk Management and Insurance Activities

1. Automobile, Fire and Other Property Losses

The State is required by Chapter 58, Article 31, Part 50, of the General Statutes to provide liability insurance on every state-owned motor vehicle, which includes vehicles held by the State's participating component units. The State is self-insured for the first $250,000 of any loss through a retrospective rated plan. The plan purchases excess insurance through a private insurer to cover losses greater than $250,000. The liability limits for losses incurring in-state are $150,000 per claimant and $5 million per occurrence. For losses incurring out-of-state, the limits are $1 million per claimant and $5 million per occurrence. Covered losses include those that occur with vehicles that are not on a stationary track or rail, and federal vehicles when the Governor calls out the National Guard.

Agencies of the State and participating component units using state cars are charged premiums to cover the cost of the excess insurance and to pay for those losses falling under the self-insured retention. Premiums charged are also based on the projected losses to be incurred. The private insurer processes all claims and sets up a reserve for amounts expected to be paid for claims. Claims are paid by the private insurer after they are approved by the Attorney General's Office. Settled claims have not exceeded coverage in any of the past three fiscal years.

The State Property Fire Insurance Fund (the Fund), an internal service fund of the State, was created by Chapter 58, Article 31, of the General Statutes. The Fund insures State owned buildings and contents for fire, extended coverage, and other property losses. Coverage for fire losses is free for all operations that are supported by the State's General Fund. Those operations that are not supported by the State's General Fund are charged for fire coverage. Agencies of the State can purchase extended coverage and other property coverage such as sprinkler leakage, business interruption, vandalism, theft, and "all risk" for buildings and contents through the Fund. For those that elect to receive any of this other coverage, the Fund charges premiums discounted from industry manual rates. The Fund insures fire losses up to $1.1 million per occurrence and extended coverage losses up to $100,000 per building and $500,000 per occurrence, except for wind losses by named storms, which are covered up to 1% of the value for each location up to a maximum of $3 million per occurrence. All losses covered by the Fund are subject to a $500 per occurrence deductible except for theft, which carries a $1,000 per occurrence deductible.

The Fund purchases excess insurance from a private insurer to cover losses over the amounts insured by the Fund. If aggregate uninsured losses sustained by the Fund, other than wind losses by named storms, reach $5 million in any one annual period, the Fund's deductible for the remainder of the annual period is $100,000 per occurrence. Settled claims have not exceeded coverage in any of the past three fiscal years.

Claims are paid when the Council of State approves the request for payment. Claims costs are recognized when they are approved by the Council of State and are outstanding for payment; when known estimates of losses are waiting to be submitted to the Council of State for approval; or when a loss occurs and can be reasonably estimated. Claims payable at June 30, 1999 are disclosed on the balance sheet as a combination of claims payable of $518 thousand, due to other funds of $2.656 million, and due to component units of $184 thousand. Changes in the balances of claims liabilities for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
1997-98	$ 2,551	$ 324	$ 2,255	$ 620
1998-99	620	5,043	2,305	3,358

2. Medical Malpractice Protection

a. *Professional Liability Insurance for State Medical Personnel*

All agencies of the State and participating component units are insured for tort claims up to $150,000 under the authority of the State Tort Claims Act, Chapter 143, Article 31, of the General Statutes. Organizations within the reporting entity carry excess commercial liability insurance to supplement the coverage provided by the State Tort Claims Act; however, claims involving medical malpractice are generally excluded from this coverage. The University of North Carolina at Chapel Hill Medical School (UNC-CH Medical School) and UNC Hospitals participate in the Liability Insurance Trust Fund, which is described in detail below. All other universities purchase commercial liability insurance. Chapter 443, Section 11.32, of the 1997 Session Laws of North Carolina authorized the Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction to provide medical liability coverage on behalf of employees licensed to practice medicine or dentistry; all licensed physicians who are faculty members of the University of North Carolina who work on contract for the Division of Mental Health, Developmental Disabilities, and Substance Abuse Services for incidents that occur in Division programs; and on behalf of medical residents from the University of North Carolina who are in training at institutions operated by the Department of Health and Human Services. The extent of coverage is a maximum of $1 million for each individual incident and does not affect current coverage under the State Tort Claims Act. The Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction purchase commercial professional liability insurance for their medical staff. Settled claims have not exceeded coverage in any of the past three fiscal years.

Insurance coverage varies depending upon the amount of coverage and the type of policy. Typically the amount of primary coverage for medical liability is $1 million per individual, claim, or incidence, and $3 million total or aggregate. Many departments and institutions maintain excess policies to provide additional coverage above that provided by the primary policy for medical liability. The policies are written on a claims made or occurrence basis, with the majority of the policies being claims made. The claims liabilities are not measurable.

b. *Self-Insurance through the Liability Insurance Trust Fund*

The Liability Insurance Trust Fund (Trust Fund) was created by Chapter 116, Article 26, of the General Statutes and the University of North Carolina Board of Governors Resolution of June 9, 1978, to provide medical malpractice protection for program participants and individual health care practitioners working as employees, agents, or officers of the program participants. The program participants are University of North Carolina Hospitals at Chapel Hill (UNC Hospitals) and the University of North Carolina at Chapel Hill Physicians and Associates, both of whom are a part of the University of North Carolina system, which is a component unit of the reporting entity. Coverage is self-funded by contributions from participants and investment income. Contributions are based on the actuarially determined funding level for a given plan year.

Coverage is provided on an occurrence basis. The Trust Fund limits the coverage to $3 million per occurrence and to $8 million in the annual aggregate. Commercial excess insurance is purchased with $25 million per occurrence and $50 million annual aggregate retention limits provided above the self-insurance retentions (excluding UNC Hospitals). The Trust Fund purchased a primary policy for dental residents on a claims made basis with $1 million per occurrence and $3 million annual aggregate limits of coverage. In the event the Trust Fund has insufficient funds to pay existing and future claims, it has the authority to borrow necessary amounts up to $30 million. Any such borrowing would be repaid from the assets and revenues of program participants. No borrowings have been made under this authority to date.

The Trust Fund establishes claim liabilities based on estimates of the ultimate cost of all losses and loss adjustment expenses, including losses and loss adjustment expenses incurred but not yet reported, which are unpaid at the balance sheet date. The claims liability of $35,850,822 and $33,557,782 is the present value of the aggregate actuarially determined claims liability of $37,980,302 and $35,897,811, discounted at rates ranging from 6% to 7%, at June 30, 1998 and 1999, respectively. These estimates are reviewed annually, and as adjustments become necessary, such adjustments are reflected in current operations. Claims against participants are paid from the corpus of the Trust Fund. Changes in the Trust Fund's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
1997-98	$ 30,868	$ 8,911	$ 3,928	$ 35,851
1998-99	35,851	8,044	10,337	33,558

3. Public Officers' and Employees' Liability Insurance

In accordance with Chapter 58, Article 32, Part 15, of the General Statutes, public officers' and employees' liability insurance is provided by private insurers for all employees of the State and participating component units except for doctors and dentists. The policy provides $11 million excess insurance over the $150,000 statutory limit payable for any one claim under the State Tort Claims Act. Since each state agency or component unit is responsible for funding any tort claims of $150,000 or less from their budget, total claims liabilities are not measurable. Employers are charged a premium for the excess insurance based on a composite rate. The employers pay the premiums directly to the private insurer. Settled claims have not exceeded coverage in any of the past three fiscal years.

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4. Employee Dishonesty and Computer Fraud

Blanket public employee dishonesty and computer fraud insurance is provided for agencies of the State and its component units with a limit of $5 million per occurrence, subject to a $10,000 deductible. This coverage is placed with a private insurance company and is handled by the North Carolina Department of Insurance. Agencies of the State and its component units are charged premiums by the private insurance company. A small number of State agencies and component units of the State require faithful performance coverage in addition to employee dishonesty coverage. In these instances, separate policies have been purchased. The amounts of coverage and the deductibles vary among these separate policies. Settled claims have not exceeded coverage in any of the past three fiscal years.

5. Statewide Workers' Compensation Program

The Workers' Compensation Program (the Program) was created by Chapter 97, Article 1, of the General Statutes to provide benefits to workers injured on the job. All employees of the State and its component units are included in the Program. An injury is covered under workers' compensation if it is caused by an accident that arose out of and in the course of employment. Also, certain occupational diseases specifically designated in the North Carolina Workers' Compensation Act are compensable. Losses payable by the Program include medical claims, loss of wages, disability, and death benefits. Payments of all medical benefits are subject to approval based on a fee schedule established by the North Carolina Industrial Commission (NCIC). Loss of wages and disability benefits are payable based on 66 2/3% of an employee's average weekly salary subject to a statutory compensation rate minimum and maximum established annually by the NCIC. Death benefits are payable for 400 weeks at 66 2/3% of an employee's average weekly salary. In certain instances, death benefits may be extended beyond the 400 weeks.

The responsibility for claiming compensation is on the injured employee. If the injured employee or his representative does not notify the employer within 30 days from the date of injury, the employer can refuse compensation. A claim must be filed with the NCIC by either the employee or the employer within two years from the date of knowledge thereof; otherwise the claim is barred by law and no further compensation is allowable. When an employee is injured, the employer's primary responsibility is to arrange for and provide the necessary treatment for any work-related injury. The employer tries to provide the best possible medical care for injured employees to help them reach maximum medical improvement and return to work as soon as possible.

On April 1, 1996, the Workers' Compensation Cost Containment Pilot Project was developed by the Office of State Budget and Management and the Office of State Personnel by authority of Chapter 507, Section 11.1 of the 1995 Session Laws. Seventeen state agencies and universities volunteered to participate in the Project. A third-party administrator was selected in a bidding process to administer workers' compensation claims for these seventeen agencies and universities. The seventeen agencies and universities contribute to a fund set up in the Office of the State Controller, which is administered by the Office of State Personnel, to cover their workers' compensation claims. During the fiscal year, the pilot project was deemed a success and the pilot status removed. A third party administrator was selected for the new program effective April 1999. The third party administrator receives a per case administration fee and draws down State funds to make medical and indemnity payments on behalf of the State. For the remainder of the fiscal year (April, May and June), participation was limited to the original pilot participants. Participation is mandatory for the remaining State agencies and institutions effective July 1, 1999 (with some exceptions). The workers' compensation cost of the seventeen agencies is included in the schedule below. For the other non-participating agencies and universities, each employer accepts or denies liability for the reporting entity and is responsible for monitoring and processing the claims. The employer is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act.

The State and its component units are self-insured for workers' compensation. Each state agency and participating component unit is responsible for paying claims out of its individual budget. Budgets for workers' compensation for most State agencies and participating component units are based on the prior year's loss experience. Since the related liability is not measurable, claim costs are recognized when paid. The Department of Transportation is the only state agency or component unit that sets up a reserve for claims. For the year ended June 30, 1999, workers' compensation costs were recognized as follows (dollars in thousands):

Primary government	$ 38,192
University of North Carolina system	3,150
All other component units	2
Total	$ 41,344

6. Workers' Compensation Fund

The Workers' Compensation Fund (the Fund) is an insurance enterprise reported within the enterprise funds. The Fund is created in the Department of Insurance (the Department) and is administered by the State Fire and Rescue Commission (the Commission) through a service contract with a third-party administrator. In accordance with Chapter 58, Article 87, of the General Statutes, the purpose of the Program is to provide workers' compensation benefits to members of "eligible units," which consist of volunteer fire departments or volunteer rescue/EMS units that are not part of a unit of local government and are exempt from State income tax under G.S. 105-130.11. These eligible units are not part of the reporting entity. Benefits are payable for compensable injuries or deaths which occurred on or after July 1, 1996. The Fund is financed by appropriations made to the Department for this purpose and by per capita fixed dollar amounts for each member of a participating eligible unit's roster. The per capita fixed dollar amount is set annually by the Commission and is paid by the eligible units to the Commission on or before July 1 of each year for credit to the Fund. If payment is not received by July 1, the eligible unit shall not receive workers' compensation coverage for that fiscal year. The appropriation for the fiscal year ended June 30, 1999 was $4.5 million. As of June 30, 1999, the Fund consisted of 1,152 eligible units representing approximately 36,035 members.

The liability for unpaid claims is based on an actuarial determination and represents a reasonable estimate of the ultimate cost of open claims and claim settlement expenses that are unpaid as of the fiscal year end, including incurred but not reported losses. The liability for unpaid claims is continually reviewed, and as adjustments become necessary such adjustments are included in current operations. The Program considers anticipated investment income in determining if a premium deficiency exists. The Program recognizes subrogation from third parties as a reduction to claim and claim settlement expenses incurred. As of June 30, 1999, there was no reduction for subrogation.

Acquisition costs consist of commission payments to independent insurance agents for marketing, promotional and administrative assistance with policy maintenance to eligible units. As coverage is renewed annually, acquisition costs are not amortized.

The Program maintains both specific excess of loss and aggregate reinsurance coverage. The specific excess of loss coverage provides for statutory limits above the Program's retention of $350,000 per occurrence and a $1 million limit for employer's liability above the Program's retention of $350,000 per occurrence. The aggregate reinsurance provides for $3 million of coverage above aggregate Program losses of $4,427,159 for policy year 1998-1999. Incurred losses are reduced by estimated amounts recoverable under the Program's excess of loss and aggregate reinsurance policies. As of June 30, 1999, there are claims recoverable from reinsurers in the amount of $829,967.

The following schedule shows the changes in the reported liability for the past two fiscal years (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
1997-98	$ 2,962	$ 3,144	$ 1,248	$ 4,858
1998-99	4,858	3,568	2,025	6,401

7. Health Insurance Program for Children

The Health Insurance Program for Children (the Program) is an insurance enterprise reported within the enterprise funds. The Program was created by Chapter 108A, Article 2, Part 8, of the General Statutes to provide comprehensive health insurance coverage to uninsured low-income children who are residents of this State. Health benefits coverage provided to children eligible under the Program is equivalent to coverage provided for dependents under the North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan (the Plan) which is discussed in part B.1. of this note. In addition to the benefits provided under the Plan, the Program also provides coverage for dental, hearing, and vision services and supplies.

Coverage is provided from federal funds received, State funds appropriated, and other nonappropriated funds made available for this purpose. All appropriations, allocations, premium receipts, or any other receipts, including earnings on investments, occurring or arising in connection with acute medical care benefits provided under the Program are deposited into the Child Health Insurance Fund (the Fund). Disbursements from the Fund include any and all amounts required to pay the benefits and administrative costs of the Program. For the fiscal year ended June 30, 1999, $15,617,822 was appropriated from the General Fund to the North Carolina Department of Health and Human Services (DHHS) to be used for the Program.

The Program is administered by DHHS. Eligible children may be enrolled by DHHS based on the availability of funds. The Plan is responsible for the administration and processing of claims for benefits under the Program, as provided under Chapter 135, Article 3, Part 5 of the General Statutes. The Plan's self-insured indemnity program shall not incur any financial obligations for the program in excess of the amount of funds that the Plan's self-insured indemnity program receives for the program.

Annual enrollment fees, copayments, or other cost-sharing charges are determined by family income. However, there are no enrollment fees, deductibles, copayments, or other cost-sharing charges for families covered under the Program whose family income is at or below 150% of the federal poverty level. A family's total annual aggregate cost-sharing charges shall not exceed five percent of the family's income for the year involved. As of June 30, 1999, 43,331 children were insured under the Program.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). The following schedule shows the change in the claims liability for the Program's initial fiscal year of operation (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
1998-99	$ —	$ 22,407	$ 16,193	$ 6,214

NOTE 13: SEGMENT INFORMATION FOR ENTERPRISE FUNDS

Segment information for the State's enterprise funds for the year ended June 30, 1999 is presented below (dollars in thousands).

	Public School Insurance [1]	Child Health Insurance Program [2]	N.C. State Fair [3]	USS North Carolina Battleship Commission [4]	Agricultural Farmers Market [5]	Workers' Comp. [6]	Indian Cultural Tourist Center [7]	Other Funds [8]	Total
Operating revenues.............	$ 6,967	$ 217	$ 8,608	$ 2,217	$ 844	$ 2,212	$ 4	$ 1,355	$ 22,424
Depreciation/amortization.....	—	—	595	190	623	—	11	64	1,483
Operating income (loss)........	(469)	(25,232)	1,051	168	(653)	(2,452)	(7)	(105)	(27,699)
Operating transfers in...........	—	27,582	—	—	120	—	—	205	27,907
Operating transfers (out).......	—	—	(1,279)	—	(2)	—	—	—	(1,281)
Net income (loss).................	(469)	2,350	(169)	732	(496)	(2,452)	(7)	152	(359)
Current capital contribution...	—	—	57	200	22	4,500	—	—	4,779
Fixed assets:									
Additions..........................	—	—	44	155	38	—	—	84	321
Deletions..........................	—	—	—	8	—	—	—	—	8
Current assets......................	46,408	13,979	5,193	3,253	803	17,229	32	586	87,483
Current liabilities..................	15,496	11,629	716	127	62	10,095	—	52	38,177
Net working capital..............	30,912	2,350	4,477	3,126	741	7,134	32	534	49,306
Total assets..........................	46,408	13,979	13,385	5,337	10,287	17,229	500	2,421	109,546
Total equity (deficit).............	30,912	2,350	12,669	5,210	10,225	7,134	500	2,369	71,369

Principal enterprise fund activities:

[1] The **Public School Insurance** fund provides fire, theft and vandalism insurance for public school buildings and contents and offers risk management services.

[2] The **Child Health Insurance Program** provides comprehensive health insurance coverage to uninsured low-income children who are residents of this State.

[3] The **N.C. State Fair** in Raleigh provides annual competitive exhibition of North Carolina agricultural products as well as rural arts and crafts.

[4] The **USS North Carolina Battleship Commission** in Wilmington is open for public exhibition all year. The Commission administers the maintenance and exhibition costs of the battleship.

[5] The **Agricultural Farmers Market** in Raleigh provides a site where state farmers can sell fresh produce and other agricultural products directly to the public.

[6] The **Workers' Compensation Fund**, provides benefits to volunteer safety workers for workers' compensation. This fund is administered by the N.C. Department of Insurance.

[7] The **Indian Cultural Tourist Center**, located in Robeson County, is to promote and preserve the culture of the Indian people.

[8] **Other Governmental Enterprise Funds** have been organized to operate concession stands, bookstores, and vending and sales desks.

NOTE 14: COMPONENT UNITS — CONDENSED FINANCIAL INFORMATION

Condensed financial statements for the component unit funds as of and for the fiscal year ended June 30, 1999 are presented below (dollars in thousands).

Condensed Balance Sheet
Component Units - Proprietary Funds

	N.C. Housing Finance Agency	*State Education Assistance Authority*	*N.C. State Ports Authority*	*North Carolina Railroad Company*	*N.C. Low Level Radio-Active Waste Management Authority*	*N.C. Global TransPark Authority*	*MCNC*	*Other Component Units*	*Total Proprietary Component Units*
Current assets									
Due from primary government.....	$ —	$ 14,531	$ —	$ —	$ —	$ —	$ —	$ —	$ 14,531
Other...	44,318	555,454	43,895	6,198	450	31,384	9,267	85,325	776,291
Non-current assets.......................	1,138,456	528,810	193	—	—	—	460	4,364	1,672,283
Fixed assets................................	448	974	122,063	7,861	—	26,363	9,965	9,054	176,728
Total Assets..................................	$ 1,183,222	$ 1,099,769	$ 166,151	$ 14,059	$ 450	$ 57,747	$ 19,692	$ 98,743	$ 2,639,833
Current liabilities									
Due to primary government.........	$ 3	$ —	$ —	$ 1,843	$ —	$ 710	$ —	$ 6,330	$ 8,886
Other...	114,037	134,567	4,521	1,088	235	4,907	8,231	19,671	287,257
Long-term liabilities									
Advance from primary government...............................	—	—	—	61,000	—	25,000	—	—	86,000
Bonds payable............................	924,005	521,477	11,760	—	—	—	—	—	1,457,242
Other...	—	10,922	614	—	—	—	1,726	5,588	18,850
Fund equity...................................	145,177	432,803	149,256	(49,872)	215	27,130	9,735	67,154	781,598
Total liabilities and fund equity......	$ 1,183,222	$ 1,099,769	$ 166,151	$ 14,059	$ 450	$ 57,747	$ 19,692	$ 98,743	$ 2,639,833

Condensed Statement of Revenues, Expenses and Changes in Fund Equity
Component Units - Proprietary Funds

	N.C. Housing Finance Agency	*State Education Assistance Authority*	*N.C. State Ports Authority*	*North Carolina Railroad Company*	*N.C. Low Level Radio-Active Waste Management Authority*	*N.C. Global TransPark Authority*	*MCNC*	*Other Component Units*	*Total Proprietary Component Units*
Operating revenues......................	$ 83,514	$ 64,066	$ 28,119	$ 2,132	$ —	$ 337	$ 36,241	$ 10,695	$ 225,104
Operating expenses									
Depreciation/amortization..........	153	468	7,557	9	—	377	—	708	9,272
All other....................................	73,311	58,141	20,746	1,417	—	2,022	38,917	12,024	206,578
Operating income.........................	10,050	5,457	(184)	706	—	(2,062)	(2,676)	(2,037)	9,254
Operating transfers from component units.......................	—	12,002	—	—	—	—	—	—	12,002
Operating transfers from primary government..................	2,300	14,531	—	—	—	8,446	4,500	108,010	137,787
Operating transfers to primary government..................	(51)	—	(1)	—	—	—	—	—	(52)
Other nonoperating revenues (expenses)..................	—	645	364	(2,128)	(621)	3,421	(912)	(85,039)	(84,270)
Net income (loss)..........................	12,299	32,635	179	(1,422)	(621)	9,805	912	20,934	74,721
Excess of revenues over (under) expenditures from governmental operations............	(148)	—	—	—	—	—	—	—	(148)
Fund equity - July 1......................	133,026	405,626	135,312	(44,557)	(49,564)	2,128	10,909	63,763	656,643
Other changes in equity................	—	(5,458)	13,765	(3,893)	50,400	15,197	(2,086)	(17,543)	50,382
Fund equity - June 30...................	$ 145,177	$ 432,803	$ 149,256	$ (49,872)	$ 215	$ 27,130	$ 9,735	$ 67,154	$ 781,598

NOTES TO THE FINANCIAL STATEMENTS

Condensed Balance Sheet
Component Units - College and University Funds

	University Funds	Community Colleges Funds	Total College and University Funds
Assets			
Due from other funds	$ 60,901	$ 528	$ 61,429
Due from component units	1,022	—	1,022
Due from primary government	13,819	28,898	42,717
Fixed assets	5,020,923	1,226,763	6,247,686
Other	4,443,467	224,866	4,668,333
Total assets	$ 9,540,132	$ 1,481,055	$ 11,021,187
Liabilities			
Due to other funds	$ 60,901	$ 528	$ 61,429
Due to component units	1,022	—	1,022
Due to primary government	1,422	3,125	4,547
Bonds payable	897,654	—	897,654
Notes payable	18,892	1,271	20,163
Other	1,391,962	85,349	1,477,311
Total liabilities	2,371,853	90,273	2,462,126
Fund equity			
Total fund equity	7,168,279	1,390,782	8,559,061
Total liabilities and fund equity	$ 9,540,132	$ 1,481,055	$ 11,021,187

Condensed Statement of Revenues, Expenditures, and Changes in Fund Equity
Component Units - College and University Funds

	University Funds	Community Colleges Funds	Total College and University Funds
Revenues	$ 3,219,200	$ 461,465	$ 3,680,665
Expenditures	4,450,089	1,047,395	5,497,484
Operating transfers from primary government	1,799,860	652,597	2,452,457
Operating transfers to primary government	(20,332)	—	(20,332)
Operating transfers to component units	(12,002)	—	(12,002)
Net increase in fund equity	536,637	66,667	603,304
Fund equity - July 1	6,523,755	1,322,792	7,846,547
Other changes in equity	107,887	1,323	109,210
Fund equity - June 30	$ 7,168,279	$ 1,390,782	$ 8,559,061

Condensed Statement of Current Funds Revenues, Expenditures, and Transfers
Component Units - College and University Funds

	University Funds	Community Colleges Funds	Total College and University Funds
Revenues	$ 2,171,618	$ 277,030	$ 2,448,648
Expenditures	3,545,136	878,266	4,423,402
Transfers and Additions (Deductions):			
Excess of restricted receipts over transfers to revenues	10,526	1,445	11,971
Refunded to grantors	(1,354)	—	(1,354)
Mandatory transfers	(61,874)	(3)	(61,877)
Non-mandatory transfers	(39,132)	(2,568)	(41,700)
Interinstitutional transfers	(2,338)	—	(2,338)
Operating transfers from primary government	1,580,716	605,305	2,186,021
Operating transfers to primary government	(1,549)	—	(1,549)
Operating transfers to component units	(12,002)	—	(12,002)
Net increase in fund equity	$ 99,475	$ 2,943	$ 102,418

NOTE 15: RESERVED AND UNRESERVED DESIGNATED FUND BALANCES

The State and its component units' reserved fund balances represent those portions of fund balance that are (1) not available for appropriation or expenditure, which includes loans receivable and long-term portion of advances to other funds, or (2) fund balances that are legally segregated for a specific use. The primary government's reserved fund balances at June 30, 1999, are (dollars in thousands):

	Governmental Fund Types			Fiduciary Funds				
	General	*Special Revenue*	*Capital Projects*	*Expendable Trust*	*Non-expendable Trust*	*Pension Trust*	*Investment Trust*	*Fiduciary Totals*
Inventories	$ 48,105	$ 30,598	$ —	$ 1,245	$ —	$ —	$ —	$ 1,245
Reserved for specific encumbrances	465,366	14,228	—	—	—	—	—	—
Retirees' health premiums	297,661	—	—	—	—	—	—	—
Energy conservation	—	—	—	1,856	—	—	—	1,856
Investments	51	—	—	—	—	—	—	—
Other purposes	—	1,230	—	635	26	—	—	661
Medicaid programs	162,272	—	—	—	—	—	—	—
Continuing programs	46,287	—	—	—	—	—	—	—
Contributions	990	—	—	—	—	—	—	—
Advances to component units	61,000	—	—	25,000	—	—	—	25,000
Intangible tax refunds	1,561	—	—	—	—	—	—	—
Federal retirees' refund account	287	—	—	—	—	—	—	—
Vacation, sick leave	—	30,129	—	—	—	—	—	—
Notes receivable	497	111,095	—	—	259,543	—	—	259,543
Prepaid items	—	386	—	—	—	—	—	—
Capital projects	—	—	82,076	—	—	—	—	—
Claims and benefits	—	—	—	569,952	—	—	—	569,952
Loan and grant commitments	—	705,698	—	9,695	112,238	—	—	121,933
Abandoned property	—	—	—	204,806	—	—	—	204,806
Political parties	—	—	—	125	—	—	—	125
Wildlife endowment	—	—	—	—	41,318	—	—	41,318
Investment pool participants	—	—	—	—	—	—	746,005	746,005
Employees' pension benefits	—	—	—	—	—	56,272,203	—	56,272,203
Total Fund Balances Reserved	$ 1,084,077	$ 893,364	$ 82,076	$ 813,314	$ 413,125	$ 56,272,203	$ 746,005	$ 58,244,647

The State's unreserved fund balance designations in the General Fund represent tentative plans for use in a future period. These fund balance designations were reported as reserves in prior years. For fiscal year 1998-99, the State changed its accounting policy to only report reserves in connection with restrictions imposed by parties outside of the financial reporting entity. Since the State's internal governing body established the restrictions on the use of these assets, they are now reported as fund balance designations. Fund balance designations in the General Fund are established based on the amount of reserves available as measured on the budgetary basis of accounting. These designations totaled $269.651 million. As shown in the table below, the fund balance available to be designated totaled only $60.053 million on a modified accrual basis (dollars in thousands):

Unreserved Designated Fund Balance	*General Fund*
Repairs and renovations	$ 164,683
Clean Water Management Trust Fund	31,054
Disproportionate share	19,552
Aquariums	30,000
Work First	17,362
Capital projects	7,000
Total designations	$ 269,651
Unreserved fund balance, Exhibit A-1	$ 60,053

The component units' reserved fund balances at June 30, 1999, are (dollars in thousands):

Restricted Funds	*University*	*Community Colleges*	*Total College and University Funds*
Loans	$ 98,266	$ 992	$ 99,258
Endowments	837,429	16,644	854,073
Revenue bonds	71,749	—	71,749
Restricted funds	648,444	104,250	752,694
Total Fund Balances Reserved	$ 1,655,888	$ 121,886	$ 1,777,774

NOTE 16: FUND EQUITY RECLASSIFICATIONS AND RESTATEMENTS

As a result of review during the current reporting period, certain funds were reclassified from their June 30, 1998 presentation to more appropriate fund types. The effects of these reclassifications appear in the "Entity Changes/Fund Reclassification" column. Some fund equity balances as of July 1, 1998, are restated for certain accounting changes or adjusted for the correction of errors in the reported balances of the fiscal year ended June 30, 1998. These changes are shown in the "Prior Year Adjustments and Restatements" column. On April 1, 1998, the State loaned $61 million to the North Carolina Railroad Company (Railroad), a component unit of the State, for the purpose of acquiring the Railroad's non-State owned shares of outstanding common stock. The Railroad's acquisition of its outstanding shares of common stock resulted in a $58.432 million reduction of its fund equity as of July 1, 1998. The following table summarizes the above changes as they appear in the accompanying financial statements (dollars in thousands).

	June 30, 1998 Fund Equity as Previously Reported	Entity Changes/ Fund Reclass-ification	Acquisition of Treasury Stock	July 1, 1998 Fund Equity as Reported	Prior Year Adjustments/ Restatements	July 1, 1998 Fund Equity as Restated
Primary Government						
General Fund..	$ 1,664,650	$ 137	$ —	$ 1,664,787	$ (953)	$ 1,663,834
Special Revenue..................................	2,484,573	(136)	—	2,484,437	52,691	2,537,128
Capital Projects....................................	258,584	—	—	258,584	3,506	262,090
Enterprise...	68,712	—	—	68,712	(1,763)	66,949
Internal Service....................................	654,433	—	—	654,433	135	654,568
Expendable Trust Funds......................	3,752,949	(1,469,770)	—	2,283,179	15,771	2,298,950
Nonexpendable Trust Funds................	412,052	(1)	—	412,051	(27)	412,024
Pension Trust Funds............................	49,334,679	1,469,770	—	50,804,449	—	50,804,449
Investment Trust Fund.........................	306,610	—	—	306,610	35,804	342,414
Total Primary Government................	58,937,242	—	—	58,937,242	105,164	59,042,406
Component Units						
Proprietary Funds.................................	790,065	(74,990)	(58,432)	656,643	6,911	663,554
College and University:						
University funds..................................	6,523,755	—	—	6,523,755	107,978	6,631,733
Community colleges funds.................	1,325,683	(2,891)	—	1,322,792	1,323	1,324,115
Total Component Units......................	8,639,503	(77,881)	(58,432)	8,503,190	116,212	8,619,402
Total Reporting Entity.........................	$ 67,576,745	$ (77,881)	$ (58,432)	$ 67,440,432	$ 221,376	$ 67,661,808

NOTE 17: RESIDUAL EQUITY TRANSFERS

Residual equity transfers out exceed residual equity transfers in by $51.943 million due to the following transactions: (1) $8.015 million transferred out from the Capital Projects Fund and $5.750 million transferred out from the General Fund to the State Ports Authority (Proprietary Component Unit), recorded by the Authority as an increase in contributed capital. (2) $4.5 million transferred out from the General Fund to the Workers' Compensation Fund (Enterprise Fund) recorded by the Workers' Compensation Fund as an increase in contributed capital. (3) $33.599 million transferred out from the General Fund to the N.C. Low Level Radioactive Waste Management Authority (Proprietary Component Unit), recorded by the Authority as an increase in contributed capital. (4) $57 thousand transferred out of the Capital Projects Fund to the N.C. State Fair (Enterprise Fund), recorded by the Fair as an increase in contributed capital. (5) $22 thousand transferred out of the Capital Projects Fund to the Agricultural Farmers Market (Enterprise Fund), recorded by the Market as an increase in contributed capital.

NOTE 18: COMMITMENTS AND CONTINGENCIES

A. No Commitment Debt

The State, by action of the General Assembly, created the North Carolina Medical Care Commission which is authorized to issue tax-exempt bonds and notes to finance construction and equipment projects for nonprofit and public hospitals, nursing homes, continuing care facilities for the elderly and related facilities. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each entity is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2029, the outstanding principal of such bonds and notes as of June 30, 1999, was $3.4 billion with interest rates varying from 2.30 % to 8.00 %.

The State, by action of the General Assembly, created the North Carolina Educational Facilities Finance Agency which is authorized to issue tax-exempt bonds and notes to finance facilities and structures at private institutions of elementary, secondary, and postsecondary education. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each issue is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2028, the outstanding principal of such bonds and notes as of June 30, 1999, was $598.7 million with variable interest rates.

The State, by action of the General Assembly, created the North Carolina Industrial Facilities and Pollution Control Financing Authority which is authorized to issue tax-exempt bonds and notes to provide funds to be loaned by the Authority to finance industrial and manufacturing facilities, pollution control facilities for industry (in connection with manufacturing) where there is a favorable impact on employment or pollution control commensurate with the size and cost of the facilities. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each issue is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2009, the outstanding principal of such bonds and notes as of June 30, 1999, was $7.9 million with variable interest rates.

B. Litigation

***Leandro et al v. State of North Carolina and State Board of Education* — Right to a Sound Basic Education.** In 1994, students and boards of education in five counties in the State filed suit in Superior Court requesting a declaration that the public education system of North Carolina, including its system of funding, violates the State constitution by failing to provide adequate or substantially equal educational opportunities, by denying due process of law, and by violating various statutes relating to public education. Five other school boards and students therein intervened, alleging claims for relief on the basis of the high proportion of at-risk and high-cost students in their counties' systems.

The suit is similar to a number of suits in other states, some of which resulted in holdings that the respective systems of public education funding were unconstitutional under the applicable state law. The State filed a motion to dismiss, which was denied. On appeal the North Carolina Supreme Court upheld the present funding system against the claim that it unlawfully discriminated against low wealth counties but remanded the case for trial on the claim for relief based on the Court's conclusion that the constitution guarantees every child the opportunity to obtain a sound basic education. Trial on the claim of one plaintiff-county is set for September 1999. The North Carolina Attorney General's Office believes that sound legal arguments support the State's position on the outstanding claims.

***Bailey v. State, Emory v. State, and Patton v. State* -- State Tax refunds -- State and Federal Retirees.** In 1992, State and local government retirees filed *Bailey, et al. v. North Carolina, et al*., a class action lawsuit challenging repeal of the income tax exemptions for State and local government retirement benefits as a breach of contract and an unconstitutional impairment of their contract rights and seeking tax refunds for taxes paid in tax years 1989 through 1991. The *Bailey* plaintiffs obtained judgment in May 1995 in the Superior Court for Wake County, and on May 8, 1998, the Supreme Court of North Carolina upheld the Superior Court's decision. Several additional cases, also named *Bailey, et al. v. North Carolina, et al.,* and one named *Emory, et al. v. North Carolina, et al.*, were filed by State and local government retirees to preserve their refund claims for subsequent tax years through tax year 1997. The outcome of these cases was controlled by the outcome of the initial *Bailey* case.

In 1995, a group of federal government retirees filed *Patton, et al. v. North Carolina, et al.*, a class action tax refund lawsuit seeking refunds of State taxes paid on federal pension income since tax year 1989. The *Patton* plaintiffs claimed that if the *Bailey* plaintiffs prevailed on their refund claims, then the disparity of tax treatment accorded state and federal pension income held unconstitutional in *Davis v. Michigan* (1989) would be reestablished. In *Davis*, the United States Supreme

Court ruled that a Michigan income tax statute that taxed federal retirement benefits while exempting those paid by state and local governments violated the constitutional doctrine of intergovernmental tax immunity. At the time of the *Davis* decision, North Carolina law contained similar exemptions in favor of State and local government retirees. The repeal of those exemptions in 1989 resulted in the *Bailey* case.

On June 10, 1998, the General Assembly reached an agreement settling the *Bailey*, *Emory* and *Patton* cases. The agreement, embodied in a consent order, provided that the State would pay $799 million in two installments, one in 1998 and the other in 1999, to extinguish all liability for refunds for tax years 1989 through 1997 of taxes paid by federal, State and local government retirees who had five years creditable service in their retirement system prior to August 12, 1989, the date of enactment of the statute repealing the exemptions from taxation of State and local government retirement benefits, or who had "vested" by that date in certain "defined contribution" plans such as the State's 401(k) and deferred compensation plans. The consent order was conditioned upon the General Assembly appropriating the funds to make the payments set forth in the consent order and court approval of the settlement following notice to class members. A liability of $399 million was recorded in the General Fund at June 30, 1999 and paid in July 1999. All payments required of the State by the settlement agreement have now been paid. The Superior Court is supervising the remedial phase, and two remedial issues are now on appeal.

***Smith v. State and Shaver v. State* — State Tax Refunds -- Intangibles Tax.** The *Smith* case is a class action tax refund lawsuit related to litigation in *Fulton Corporation v. Faulkner*, a case filed by a single taxpayer and decided by the United States Supreme Court in 1996 regarding the constitutionality of intangibles taxes previously collected by the State on shares of stock. On July 7, 1995, while the *Fulton* case was pending before the United States Supreme Court, the *Smith* class action was commenced in North Carolina Superior Court on behalf of all taxpayers who paid the tax and complied with the requirements of the applicable tax refund statute, G.S. § 105-267, including its 30-day demand requirement. These original plaintiffs were later designated Class A when a second group of taxpayers were added. The new class, designated Class B, consisted of taxpayers who had paid the tax but failed to comply with the refund statute's 30-day demand requirement. On June 11, 1997, judgment was entered awarding the Class A plaintiffs refunds totaling $120 million, with interest, and these refunds have been paid. In a separate order also entered on June 11, 1997, Class B was decertified and the refund claims of Class B taxpayers were dismissed. Class counsel appealed the Class B decertification/dismissal order, and on December 4, 1998, the North Carolina Supreme Court reversed the dismissal. As a result of the *Smith* decision, the State will be required to pay refunds to Class B intangibles taxpayers. The State estimates that its liability for tax refunds, with interest through June 30, 1999, will be approximately $350 million.

A second class action tax refund lawsuit, *Shaver, et al. v. North Carolina, et al.*, was filed on January 16, 1998, by the same taxpayers as Class B plaintiffs in *Smith* under alternative theories of recovery for tax years 1991 through 1994 and for refunds for one additional tax year, 1990. Their additional claim for 1990 totals approximately $100 million. A Settlement Agreement was executed on July 8, 1999, and a Consent Order Tentatively Approving Settlement was executed and signed by the presiding Judge the same day. Pursuant to the Settlement Agreement and the Consent Order, the State will pay the sum of $200 million on October 1, 1999, and the sum of $240 million no later than July 10, 2000 to distribute refunds to *Smith* Class B taxpayers for tax years 1991 through 1994 and to *Shaver* taxpayers for tax year 1990. (The settlement does not affect *Smith* Class A taxpayers because they have already been paid refunds). On September 24, 1999, the Court conducted a fairness hearing and entered an order approving the Class Action Settlement. In order to achieve the final consummation of the settlement, the General Assembly must appropriate the $240 million balance for the 2000-2001 fiscal year. The settlement fixes the State's liability for these claims and should complete the litigation over North Carolina intangibles taxes paid on shares of stock.

***N.C. School Boards Association, et. al. v. Harlan E. Boyles, State Treasurer, et. al*. — Use of Administration Payments.** On December 14, 1998, plaintiffs, including county school boards of Wake, Durham, Johnston, Buncombe, Edgecombe and Lenoir Counties, filed suit in Superior Court requesting a declaration that certain payments to State administrative agencies must be distributed to the public schools on the theory that such amounts are fines which under the North Carolina Constitution must be paid to the schools.

For the last fiscal year for which information was available to them, plaintiffs allege liability of approximately $84 million. Until this matter is resolved, any refunds and interest will continue to accrue. The North Carolina Attorney General's Office believes that sound legal arguments support the State's position on the outstanding claims.

***Faulkenbury v. Teachers' and State Employees' Retirement System, Peele v. Teachers' and State Employees' Retirement System, and Woodard v. Local Governmental Employees' Retirement System* — Disability Retirement Benefits**. Plaintiffs are disability retirees who brought class actions in state court challenging changes in the formula for payment of disability retirement benefits and claiming impairment of contract rights, breach of fiduciary duty, violation of other federal constitutional rights, and violation of state constitutional and statutory rights. The Superior Court ruled in favor of the plaintiffs. The Order was affirmed by the North Carolina Supreme Court in 1997. The case went back to the Superior Court for calculations of benefits and payment of retroactive benefits, along with determination of various remedial issues. As a result of the remedial proceedings, there have been two appeals to the appellate courts concerning calculation of the retroactive benefits. The plaintiffs previously submitted documentation to the court asserting that the cost in damages and higher prospective benefit payments to the plaintiffs and class members would amount to $407 million. Calculations and payments so far indicate that retroactive benefits will be significantly less than estimated, depending in part on the pending appeal. Payments have been made by the State of approximately $83 million. A liability of $43.5 million for the retroactive benefits has been booked in the Teachers' and State Employees Retirement System.

Southeast Compact Commission — Disposal of Low-level Radioactive Waste. North Carolina and seven other southeastern states created the Southeast Interstate Low-level Radioactive Waste Management Compact to plan and develop a site for the disposal of low-level radioactive waste generated in the member states. North Carolina was assigned responsibility for development of the first disposal site, with costs to be distributed equitably among the Compact members. In 1997 the Compact Commission discontinued funding of the development of the North Carolina site, alleging that the State was not actively pursuing the permitting and development of the proposed site. North Carolina withdrew from the Compact in 1999. The Compact recently voted to pursue sanctions against North Carolina, including the repayment, with interest, by the State to the Compact Commission of $80 million of Compact member payments expended on the permitting of the site.

The North Carolina Attorney General's office believes that sound legal arguments support the State's position on this matter.

***Ford Motor Credit v. State and Chrysler Credit v. State.* – Installment Paper Dealer Tax.** The plaintiffs purchased dealer installment sales contracts from automobile manufactures that had financed new car inventories for automobile dealers in North Carolina. The Department of Revenue issued assessments against the plaintiffs, claiming that the purchase of the dealer's installment sales contracts was subject to the state of North Carolina's installment paper tax. The plaintiffs paid the tax assessments then sued the Department demanding refunds. A judgement was entered against the Department of Revenue for both cases. The combined liability is slightly over $50 million. The Department has appealed both cases. The issue raised by these cases is not expected to arise again with these taxpayers or any other taxpayers.

Other Litigation. The State is involved in numerous other claims and legal proceedings, many of which normally recur in governmental operations. A review of the status of outstanding lawsuits involving the State by the North Carolina Attorney General did not disclose other proceedings that are expected to have a material adverse effect on the financial position of the State.

C. Federal Grants

Under the terms of federal grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursement to the grantor agencies, although it is believed that disallowances, if any, will be immaterial.

D. Highway Construction

The State may be liable for approximately $87.6 million to contractors for highway construction claims that the State has contested. The State may also be liable for an additional $53.4 million in contested rights-of-way acquisition costs to property owners in condemnation proceedings. These costs have not been included in project-to-date costs. Also, the State is contingently liable for outstanding contractors' claims in the amount of $19.7 million.

E. USDA-Donated Commodities

The State has custodial responsibility for $2.7 million of U.S. Department of Agriculture donated food commodities for which the State is liable in the event of loss.

F. Construction and Other Commitments

At June 30, 1999, the State had commitments of $1,231.4 million for construction of highway facilities. Of this amount, $975.6 million relates to the Highway Fund, and $255.8 million relates to the Highway Trust Fund. The other commitments for construction and improvements of state government facilities totaled $268.8 million (including $185.5 million for the Department of Environment and Natural Resources, $19.4 million for the Department of Health and Human Services, and $18.5 million for the Department of Correction).

At June 30, 1999, the University of North Carolina system (component unit) had outstanding construction commitments of $201.5 million (including $45.3 million for UNC Hospitals, $26.9 million for University of North Carolina - Chapel Hill, and $20.3 million for Appalachian State University).

At June 30, 1999, community colleges (component units) had outstanding construction commitments of $13.3 million (including $1.9 million for College of the Albemarle and $1.4 million for Blue Ridge Community College).

At June 30, 1999, proprietary component units had outstanding commitments of $25.9 million (including $16.4 million for State Education Assistance Authority and $8.6 million for State Ports Authority).

NOTE 19: SUBSEQUENT EVENTS

Hurricane Floyd. On September 15, 1999, Hurricane Floyd hit North Carolina affecting numerous counties within the state. Hurricane Floyd brought 15 inches of rain to an area already saturated by Hurricane Dennis in late August. This disaster met or exceeded the 500-year flood plain for many communities in the eastern part of the State. Hurricane Floyd resulted in 48 confirmed fatalities, flooded approximately 30,000 homes, caused massive damages to the state's infrastructure temporarily closing over 1,000 roads, and caused over a $1.5 billion in agricultural losses. Early estimates of storm damage from Hurricane Floyd are in the range of $2.2 billion. Federal Emergency Management Agency matching requirements may approach $288 million.

North Carolina General Obligation Bonds. In September 1999, the State sold $200 million of general obligation bonds. On September 8, 1999, the State sold $177.4 million Public Improvement Bonds, Series 1999A (tax-exempt interest). The Series 1999A bonds will be dated September 1, 1999, and will mature, subject to the redemption provisions annually, March 1, $6 million, 2001 to 2007, inclusive, $9.5 million, 2008 to 2017, inclusive, $24 million 2018 and $16.4 million, 2019. The State also sold on September 8, 1999 $20 million Public Improvement Bonds, Series 1999B (federally taxable interest). The Series 1999B bonds will be dated September 1, 1999, will bear interest from that date, payable on each March 1 and September 1, beginning March 1, 2000, and will mature annually, March 1, $2.85 million 2001 to 2006, inclusive, and $2.9 million, 2007. On September 29, 1999, the State sold $2.6 million Public Improvement Bonds, Series 1999C (tax-exempt interest). The Series 1999C bonds will be dated October 1, 1999, will bear interest from that date, payable on each March 1 and September 1, beginning March 1, 2000, and will mature annually, March 1, $375,000, 2001 to 2006, inclusive, and $350,000, 2007.

North Carolina Housing Finance Agency. During July 1999, the Agency issued $55 million Home Ownership Revenue Bonds (1998 Resolution), Series 5, with rates ranging from 4.15% to 5.3%.

University of North Carolina at Chapel Hill. On August 31, 1999 the University entered into a loan agreement with First Union National Bank. Loan proceeds in the amount of $9,374,000 will provide a portion of the funds necessary for the acquisition and construction of a Neuroscience Building on campus. The total loan amount may increase to $12 million if a resolution of the Board of Governors authorizes an additional $2,626,000 for the project. Principal and interest will be paid from non-appropriated funds.

North Carolina State University. On July 24, 1998, the University signed a commitment letter with Bank of America in the amount of $14 million to fund the cost of construction of the Partners III Building and a parking deck on Centennial Campus. There has been no money drawn to date.

On July 15, 1997 the University entered into a Promissory Note with First Union National Bank for advances of up to $9.56 million to fund the cost of construction of Partner's II Building on Centennial Campus. As of June 30, 1999, $5.68 million remains outstanding. The University intends to issue 1999A variable rate tax-exempt revenue bonds for approximately $13.5 million to discharge in part the loan from First Union National Bank, to fund the construction and equipping of Partners II Building, to relocate the utility easements, and to pay the cost incurred in connection with issuance of the 1999A bonds. The University also intends to issue 1999B fixed rate bonds for approximately $2.2 million with Bank of America to discharge in part the loan from First Union National Bank, to fund the construction and equipping of Partners II Building and to pay the cost incurred in connection with the issuance of the 1999B bonds. The expected closing date is September 22, 1999.

East Carolina University. On July 13, 1999 the University sold $3.5 million in Student Fee Revenue Bonds, Series 1999, with rates ranging from 4.75% to 5.25%. The bonds were issued to provide funds to pay the cost of the renovation of and an addition to the Student Health Center on the campus and to pay related financing costs.

Anson Community College. The College was abolished by State legislation to form a new, regional community college to serve Anson and Union counties. This new College was named South Piedmont Community College on August 3, 1999. The new college immediately assumed all assets and liabilities of Anson Community College on July 1, 1999. The President of the new college is the same as was President of Anson Community College, and all employees remained employed. Essentially, the service area was enlarged and the name was changed to reflect that.

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Required Supplementary Information

REQUIRED SUPPLEMENTARY INFORMATION

YEAR 2000 ISSUES

The Year 2000 issue is the result of shortcomings in many electronic data processing systems and other equipment that may adversely affect operations in the year 1999 and beyond. For many years, programmers eliminated the first two digits from a year when writing programs. For example, programmers would designate January 1, 1965 as “01/01/65” instead of “01/01/1965.” On January 1, 2000 at 12:00:01 a.m., the internal clock in computers and other equipment will roll over from “12/31/99” to “01/01/00.” Unfortunately, many programs (if not corrected) will not be able to distinguish between the Year 2000 and the year 1900. This may cause the programs to process data inaccurately or to stop processing data altogether. Another factor that may cause problems in programs is the leap year calculation. Some programs are unable to detect the Year 2000 as a leap year.

All information systems in North Carolina that use dates to generate data will be affected by the new millennium: for example, kindergarten registration and blood supply could be affected. In addition, non-information systems such as forms need to be evaluated because they provide input to software applications. Mail processing equipment may need to be modified to handle the new millennium. Other areas such as elevators, security systems, and vaults will be affected by the Year 2000.

In early 1997, the Year 2000 Project Team (including a statewide Steering Committee and agency co-ordinators) was formed to manage the Year 2000 project from a statewide perspective. The Year 2000 Project Team is responsible for prioritizing systems statewide, developing and maintaining statewide conversion schedules, analyzing third-party product compliance, maintaining a statewide Year 2000 repository, defining the overall conversion approach and milestones, reporting the status of statewide conversion projects, providing statewide communications and coordination, reporting the status of statewide Year 2000 funding and use, reporting the status of statewide quality assurance, developing and maintaining a statewide risk management plan, coordinating the Year 2000 budget process, maintaining an evolving cost estimate, and analyzing the automated tool offerings.

The executive departments, universities, university hospitals, and community colleges are responsible for completing the Year 2000 conversion efforts in their areas. They will work within the framework set forth by the Year 2000 Steering Committee and carried through by the Statewide Year 2000 Project Team.

As of year-end, the State has contracted with several vendors for assistance in addressing the Year 2000 issues relating to its computer systems and other electronic equipment. The amount of those commitments is approximately $131 million.

The following stages have been identified as necessary to address the Year 2000 issue.

Awareness Stage—Encompasses establishing a budget and project plan (for example, a timeline or chart noting major tasks and due dates) for dealing with the Year 2000 issue.

Assessment Stage—When the organization begins the actual process of identifying all of its systems (preparing an inventory) and individual components of the systems. An organization may decide to review all system components or, through a risk analysis, identify only mission-critical systems (systems and equipment critical to conducting operations).

Remediation Stage—When the organization actually makes changes to systems and equipment. This stage deals primarily with the technical issues of converting existing systems, or switching to compliant systems. During this stage, decisions are made on how to address Year 2000 system or equipment issues, and the required system changes are made.

Validation/Testing Stage—When the organization validates and tests the changes made during the conversion process. The development of test data and test scripts, the running of test scripts, and the review of test results are crucial for this stage of the conversion process to be successful. If the testing results show anomalies, the tested area needs to be corrected and retested.

As of June 30, 1999, 1,093 application systems existed in the statewide inventory. Of those, 399 were reported by the agencies and universities as Year 2000 ready without remediation. The remaining 694 systems are in the following phases of remediation: 16 are in the assessment stage; 35 are in the remediation stage; 102 are in the validation/testing stage; and 541 have been fully remediated and placed back into production. The systems that have yet to be fully remediated have been grouped by function in the following table.

Functional Category	Assessment	Remediation	Validation/ Testing
General government	1	2	11
Education	10	5	4
Health and human services	—	3	19
Economic development	—	—	4
Environment and natural resources	1	1	8
Public safety, corrections, and regulation	1	5	5
Transportation	—	—	7
Agriculture	—	2	3
Universities	3	17	41
Total	16	35	102

REQUIRED SUPPLEMENTARY INFORMATION

The assessment process for computer systems is continuous and ongoing. The Year 2000 Project Team is also working with agencies and universities to address Year 2000 readiness issues in the other following areas: PC/LAN hardware and software, workplace infrastructure (facilities, telephones), embedded chips (medical/lab equipment, transportation vehicles, enforcement systems), supply chain partners, and business continuity planning.

Because of the unprecedented nature of the Year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the State and its component units are or will be Year 2000 ready, that the State's and its component units' remediation efforts will be successful in whole or in part, or that parties with whom the State and its component units do business will be Year 2000 ready. In addition, the completion of these stages is not a guarantee that systems and equipment will be Year 2000-compliant.

REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF FUNDING PROGRESS
ALL DEFINED BENEFIT PENSION TRUST FUNDS

June 30, 1999

(Expressed in Thousands)

Retirement System	*Valuation Date*	*Actuarial Value of Assets (a)*	*Actuarial Accrued Liability (AAL) (b)*	*Unfunded AAL (UAAL) (b) - (a)* ***NOTE 1***	*Funded Ratio (a) / (b)*	*Annual Covered Payroll (c)*	*UAAL as a Percentage of Covered Payroll ((b-a)/c)*
Teachers' and State Employees'	12-31-98	$ 30,187,100	$ 30,354,222	$ 167,122	99.4%	$ 7,994,826	2.1%
	12-31-97	27,765,057	28,071,156	306,099	98.9%	7,373,713	4.2%
	12-31-96 [A]	25,357,460	25,478,193	120,733	99.5%	6,845,185	1.8%
	12-31-95	22,178,592	22,663,750	485,158	97.9%	6,595,618	7.4%
	12-31-94	20,394,957	20,908,734	513,777	97.5%	6,323,410	8.1%
	12-31-93	18,695,663	19,274,394	578,731	97.0%	5,975,648	9.7%
Consolidated Judicial	12-31-98	$ 226,712	$ 225,944	$ (768)	100.3%	$ 40,926	(1.9)%
	12-31-97	207,706	199,204	(8,502)	104.3%	39,698	(21.4)%
	12-31-96 [A]	188,722	183,442	(5,280)	102.9%	36,608	(14.4)%
	12-31-95	164,358	175,126	10,768	93.9%	35,665	30.2%
	12-31-94	151,366	161,732	10,366	93.6%	34,114	30.4%
	12-31-93	138,419	148,495	10,076	93.2%	29,832	33.8%
Legislative	12-31-98	$ 17,885	$ 15,975	$ (1,910)	112.0%	$ 3,615	(52.8)%
	12-31-97	16,186	14,761	(1,425)	109.7%	3,605	(39.5)%
	12-31-96 [A]	14,563	13,715	(848)	106.2%	3,573	(23.7)%
	12-31-95	12,883	12,685	(198)	101.6%	3,616	(5.5)%
	12-31-94	11,281	11,137	(144)	101.3%	3,309	(4.4)%
	12-31-93	9,611	8,854	(757)	108.5%	2,264	(33.4)%
Firemen's, Rescue Squad Workers'	6-30-98	$ 158,332	$ 190,451	$ 32,119	83.1%	N/A	N/A
	6-30-97 [A]	142,169	173,030	30,861	82.2%	N/A	N/A
	6-30-96	123,265	160,233	36,968	76.9%	N/A	N/A
	6-30-95	110,196	157,644	47,448	69.9%	N/A	N/A
	6-30-94	101,563	123,691	22,128	82.1%	N/A	N/A
	6-30-93	94,542	110,204	15,662	85.8%	N/A	N/A
National Guard	12-31-98	$ 34,090	$ 43,065	$ 8,975	79.2%	N/A	N/A
	12-31-97	30,274	42,766	12,492	70.8%	N/A	N/A
	12-31-96 [A]	26,648	39,421	12,773	67.6%	N/A	N/A
	12-31-95	22,643	37,559	14,916	60.3%	N/A	N/A
	12-31-94	20,159	34,817	14,658	57.9%	N/A	N/A
	12-31-93	17,874	33,037	15,163	54.1%	N/A	N/A
Local Governmental	12-31-98	$ 7,625,281	$ 7,687,973	$ 62,692	99.2%	$ 2,929,544	2.1%
	12-31-97	6,928,217	6,991,702	63,485	99.1%	2,742,504	2.3%
	12-31-96 [A]	6,258,674	6,321,622	62,948	99.0%	2,593,671	2.4%
	12-31-95	5,411,167	5,472,970	61,803	98.9%	2,429,402	2.5%
	12-31-94	4,911,161	4,971,957	60,796	98.8%	2,280,714	2.7%
	12-31-93	4,436,587	4,517,945	81,358	98.2%	2,142,313	3.8%

NOTE 1 a negative UAAL denotes excess actuarial assets
N/A - Not applicable
A - Actuarial value of assets was revised from cost to 5-year smoothed market

The information presented in these required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information for the latest actuarial valuations is presented on page 89.

REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF CONTRIBUTIONS FROM THE EMPLOYERS AND OTHER CONTRIBUTING ENTITIES
ALL DEFINED BENEFIT PENSION TRUST FUNDS

For the Six-Year Period 1994 to 1999 (July 1 to June 30)

(Expressed in Thousands)

Retirement System	*State Fiscal Year*	*Annual Required Contribution*	*Percentage Contributed*
Teachers' and State Employees'	1999	$ 630,049	100%
	1998	610,377	100%
	1997	593,481	100%
	1996	559,980	100%
	1995	564,336	100%
	1994	526,332	100%
Consolidated Judicial	1999	$ 7,263	100%
	1998	8,485	100%
	1997	7,976	100%
	1996	7,536	100%
	1995	7,371	100%
	1994	6,991	100%
Legislative	1999	$ 770	104%
	1998	741	108%
	1997	742	108%
	1996	725	104%
	1995	739	156%
	1994	586	142%
Firemen's, Rescue Squad Workers'	1999	$ 12,105	100%
	1998	11,735	100%
	1997	11,735	100%
	1996	11,735	100%
	1995	7,449	100%
	1994	5,247	100%
National Guard	1999	$ 2,533	100%
	1998	2,533	100%
	1997	2,303	100%
	1996	2,283	100%
	1995	2,189	100%
	1994	2,189	100%
Local Governmental Employees'	1999	$ 157,764	100%
	1998	149,058	100%
	1997	142,952	100%
	1996	136,390	100%
	1995	129,915	100%
	1994	123,260	100%

The information presented in these required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information for the latest actuarial valuations is presented on page 89.